FINAL TRANSCRIPT

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PRESENTATION

John Delaney - *CapitalSource - Chairman and CEO*

Okay, why don't we get started here? Excuse me. I should have known not to eat a big plate of Chinese food before I have to stand up and talk to people. Speaking of Chinese food, last year we had Chinese food also and there were several complaints about it, and we decided to push ahead with it to prove to people that we don't do what the market wants us to do, necessarily. That was for you, Andy.

The agenda - Jason and I will start, and we plan on covering the REIT, the new reserve policy and the guidance. As most of you know, we mixed things up a little bit Monday morning and we plan on dedicating the first part of the presentation to that. So to some extent, we'll be going over many of the things we discussed, but I think it's worthy of repetition, because it's complicated and we want to spend the time on it.

I'll start and I'll go through the REIT and the reserve policy, then we'll open it up for questions, and then we'll get into a business update and guidance, which Jason will do, and then we'll open up for questions again, and then Brian Corsini, our Chief Credit Officer, will do a credit update. Then we'll have a break. We thought about planning right through to the lending group update, but we thought that was a bit cruel to push through without a break, so we're going to have a break after the credit overview, a short break, and then the lending group update, Q&A and then another break, and then Tom will provide the financial update for the business.

So let's get started. I assume everything's okay from the Webcast perspective, for the technical people in the room. Before I address the specific issues surrounding the REIT election and why we think it makes so much sense for this company, I wanted to make the point that we believe we're making this election from a position of strength, and what I mean by that is the company is a little over five years old, and across the last five years, we've built what we believe is the leading independent commercial

finance platform, with a particular focus on mid-market borrowers who are looking for a more customized debt-financing solution, which we think is the right place to be in the market. At the end of August, the business had 5.2 billion of funded loans. It's over 5.3 today, approaching 5.4. We're seeing very strong originations in the second half of the year.

We have over 8 billion of commitments in the portfolio, over 820 loans to over 500 customers, we have 22 offices, over 450 employees. This is a fully built out, functioning platform, performing at a very high level, exactly where we thought it would be. And so to some extent, what this REIT election is about, it's about our continued push to build the best business we can. We think we've built a great business, and we believe at this point in time, this election positions us to build a bigger business and a better business.

Since we've been public, we've exceeded all the expectations we've set for ourselves, and we've delivered on the promises we laid out for the market with respect to portfolio growth, with respect to return one equity and with respect to our earnings per share. The business is hitting on all cylinders. And it was from that perspective, in other words, the perspective that staying the course was very good, that the board decided to make the election that becoming a REIT was even better. So let me talk a little bit about some of the technical aspects of the REIT election.

Last week, the board approved this election. We've been studying it for 90 days. We had four board meetings across the last 30 days. It basically consumed the summer. The idea was generated by management and the board. It wasn't pitched to us by an outside adviser, though we did use three financial advisers on the transactions, otherwise known as investment banking firms, as well as our law firm and our accounting firm. It was a very significant effort and it involved a fairly large team within the company to come to this decision. It was a very important decision and we took it very seriously.

The election is transparent to shareholders, and what we mean by that is we don't need a shareholder's meetings, no votes required, we're simply making an election, or checking the box, if you will, on our 2006 tax return. But this election does have certain consequences. One of them is that we're going to be paying a special dividend and the other is we'll be an ongoing dividend payer starting in the first quarter of 2006. The special dividend is called the dividend for undistributed earnings and profits, and call it the E&P dividend, and this is something that we have to do to become a REIT. It's part of the qualification process and what you're really required to do is distribute all the earnings you've retained so that you're clean when you start as a REIT.

For us, when we were private for three years, we distributed our earnings, so we're really only looking at the period since we went public in terms of the earnings that we have to distribute. We estimate that to be somewhere between 325 and $375 million. We obviously know what the earnings of the company are, but this is a highly technical, kind of tax-driven, definition of what qualifies. So we'll have some more clarity on that soon.

This dividend will be paid before the end of January 2006. We will soon be letting people know what the record date on that dividend will be and the terms of the payment. It will either be a cash dividend or a combination of cash and stock. It has to be at least 20% stock. We will also be paying regular dividends, starting in the first quarter of 2006, and we've provided guidance with respect to what we think those dividends will be, and again, this guidance is the result of significant kind of bottoms-up work within these business groups to produce the numbers.

Our guidance for 2006 is a dividend payment of $2.15 per share, and for 2007 it's $2.90 per share. The particularly kind of high growth in the dividend from 2006 to 2007 is based on our ability not to kind of optimize the REIT structure in 2006, and I'll talk about that in a minute. The 2007 dividend is in some ways a better representation of how the company will perform, 2006 lags a little bit.

These numbers will be diluted down based on the effect of the E&P dividend, because obviously if we're distributing shares or raising capital, it dilutes down these dividends, and I'll talk about that in a minute as well. As a REIT, CapitalSource will effectively have two subsidiaries, a qualifying REIT subsidiary and a taxable REIT subsidiary. The qualifying REIT subsidiary is really the REIT for all effective purposes. This is the entity that doesn't pay any tax.

It has to be at least 75% real estate assets. Those could be direct real estate loans or asset-based loans secured by real estate, for both income and asset purposes. And the other 25% bucket can be corporate loans. So our intent is clearly to fill up the qualifying REIT subsidiary with as many real estate assets that we have and then maximize the 25% bucket with our higher-returning corporate assets, and those assets won't pay any tax. What's left, and there's a fair amount left, obviously, because CapitalSource, as most of you know, is much more than 25% corporate assets, will be in a taxable REIT subsidiary and will pay full state and federal tax on those assets.

So this is how you take a commercial finance company and you fit it into a REIT. You take the real estate assets, you put them in the qualified REIT subsidiary, you max out the 25% bucket, you don't pay tax on those assets. That's the savings. Everything else goes in this taxable REIT subsidiary and becomes fully taxed. I spoke of how there are certain inefficiencies inherent in this structure for us in the short term, and what I mean by that is we have financed our business, and I think many of you know this, historically, using securitization transactions, and we will continue to do that. The securitization transactions that we've executed have had real estate loans commingled with corporate loans, and even though we own these securitizations, we can't unbundle these securitizations for purposes of allocating real estate assets into the qualifying REIT subsidiary.

So during 2006, we have many of our real estate loans in the taxable real estate subsidiary. As those loans pay of and are replaced by new loans as part of the normal growth of the business, we will be segmenting the loans more appropriately, and we think our ability to use the qualified REIT subsidiary will be enhanced in '07, which is one of the main drivers in that dividend growth. So that's what I mean by 2006 being to some extent a lagging dividend indicator.

So there's really three reasons why we think this election makes tremendous sense for the company. The first reason relates to strategy. It's consistent with the strategic focus of the company and the evolution of the business. For those of you who have been following the company closely for the last several years, you know that we have been steering this business more towards an asset-based or an asset-oriented platform, and we've been doing that not because there's anything wrong with our non-asset-based businesses - in fact, they're doing very well. But those businesses were built faster than the asset-based businesses, based on the opportunities in the market, and we have been slowly and surely building out the asset-based platform, and we knew full well that it would become the dominant part of the platform in the future.

So, to some extent, if we were to have done this election a few years ago, it wouldn't have made much of a difference, but now it starts to make a difference, and that's one of the reasons we're doing it now. This election does also not restrict any of our non-asset-based lending businesses or our non-real estate lending businesses. If this election would have restricted our ability to grow those businesses, we would not have done it. Our view from the beginning is that we're leading with strategy here, and this election has to fit within the strategic focus of the business, and we believe it does.

It's consistent with how the business is evolving and it doesn't limit our activities. That's the first reason why this makes sense. The second reason is the obvious reason. We save a lot of money. We don't have to pay tax on all of those assets in the qualified REIT subsidiary, which is a significant savings to our shareholders that unlocks significant shareholder value, but it importantly makes the company more competitive. We have been running this business for the last five years with a certain standard for returns, which is a 30% pretax return on equity to get to a high teens, close to 20% after-tax return on equity.

For certain of our businesses that fit within the qualified REIT subsidiary, we can now pursue new opportunities and we don't have to factor the tax into the return model, so this opens up an enormous amount of opportunities for us to extend the platform in certain areas and leverage the strengths we have in the business. And, to some extent, we'll be leveraging it to a more institutional, almost a higher credit quality profile borrower, which we think makes significant sense for the business.

And the third reason this makes sense is because it unlocks shareholder value. So it fits with the strategy, it's a very efficient way to hold the asset and create new business opportunities, and it unlocks shareholder value. So the obvious question is, isn't CapitalSource a commercial finance company? We think of REITs as real estate companies. Well, to some extent, we and several others I guess are debunking the myths around REITs that they're just real estate companies.

We are a commercial finance company. We will continue to be a commercial finance company. To some extent, we have the best of both worlds. We can hold these real estate assets, or these asset-based loans that we have that are secured by real estate, in a more efficient structure. We can extend the platform as a result of that, and for the other businesses, we can keep them in the taxable REIT subsidiary and we can grow them unchecked.

So, as I said in the beginning, we believe this is about taking a great business and making it bigger and better. Our model is highly successful. Across the last five years, we built the leading independent commercial finance platform, over 450 employees in over 20 offices. It's fully built out. The origination platform is hitting on all cylinders, the credit model is working. We have a diverse and stable funding platform, we have critical mass in all of our businesses. This is a mature business that has lived up to all of our expectations, and now, with this election, we think we can position it to be better. It can be better because it can have lower cost of funds, which drives returns to the shareholders and makes us more effective and competitive in certain of our businesses.

It doesn't change some of the things that we're in and it unlocks shareholder value. So let's talk a little bit about this concept of unlocking shareholder value, because obviously this is something we studied significantly as part of this analysis. What we've detailed on this slide is a list of commercial lending REITs that we view as peers. Our financial advisers have advised us that this is the right peer group, and we agree. And we've broken them down into two categories, those that are internally managed, which means the management teams reside within the business, and those that are externally managed, which means as a management company that may be managing the REIT, we may be managing several other things.

What we've detailed is how these entities are trading today off their projected 2006 dividend yield, which is 8.65% as a group, and against their 2007 projected dividend yield, which is 9.42% as a group. Relative to these companies, we think CapitalSource has very significant advantages. First of all, we have a larger, more diverse platform. It's more built out, which should make it more stable and more predictable.

Secondly, it has higher returns on equity. Regardless of how you look at ROE, whether you look at our fully taxed ROE for the first half of the year, which was 17%, our pretax return on equity for the first half of the year, which was close to 30%, or our projected return on equity as a REIT, which is 20% plus. It's higher than these comparable groups. And, finally, our growth rate. People don't normally think of REITs necessarily as growth stocks, but our growth rate from '06 to '07 is over 35%, and that's because of some of these inefficiencies that I spoke of, so to some extent the '06 dividend is really lagging the true performance of the company.

So we believe we should trade to the absolute top of this peer group. So where does that translate into per-share value? Before we get to that question, I think we should address this E&P dividend and what it really means. As I said, this is something we have to pay. We have to pay out all the undistributed earnings of the company since we became a public company, effectively. It will be paid before the end of January, and we'll soon be announcing the record date for the payment and the terms of the payment.

But we've done a little example on this page, and assuming I can use this, it might be helpful, we've assumed that the dividend that we pay is $350 million, which is between our range of 325 to 375, a $350 million dividend, and we've assumed that the payment of that dividend is 25% cash, 75% stock. Again, it would have to be at least 25% cash.

If you own one share of CapitalSource stock, then we're projecting that your E&P dividend will be $2.61 per share, and this is taking into consideration the fact that for this model, we'll have 134 million shares outstanding, which is more shares than we have outstanding now, which means we're projecting to do a 2005 capital raise, which is fully built into these numbers.

Of the $2.61 E&P dividend you will receive, you'd be getting $0.65 of that in cash, which is the 25%, and $1.96 in stock. So that's the E&P dividend you'd receive. Your one share of stock that you'd have left after this distribution would have a projected dividend, which is the $2.15 diluted down by the additional shares that come as part of the E&P dividend for '06, and $2.67 for '07, which is the $2.90 we're projecting, diluted down by the effect of the E&P dividend.

So, in other words, our guidance was $2.15 and $2.90 after we paid the E&P dividend of $2.61 a share, you'll be left with a share of stock that will pay $1.96 and $2.67. So that's the first thing that happens. So what does that translate into where we think the stock should trade today? And, normally, we're not in the business of commenting on our share price, and obviously we have no idea where the stock will trade, which is the appropriate disclosure we should make. But, obviously, the board spent a lot of time studying this concept of unlocking shareholder value and what it really means, so we thought the wisdom of the board, together with the advice of our financial advisers, we'd share with you, because this is what we all think. And this is simply the math of where the stock should trade based upon the metrics of the comparable businesses.

And what we've done here is we've broken the companies down and we've broken the analysis down into two categories, where should we trade if we're simply lumped in with the peer group. And, again, we believe we have a superior model to the peer group, a broader, more built-out platform, higher returns, higher growth. And then we've compared it to where it should trade relative to the best-in-class company in the peer group, which is iStar, which we view as highly deserving of those best-in-class stats.

So, where should the stock trade? Well, we talked about the E&P dividend. If you had a share of stock, you'd be receiving $2.61, and again, I'm footing to my hypothetical, $0.65 in cash, $0.96 in stock. The share that you're left with would have $1.96 dividend in 2006. If you compare that to the peer group yield, the stock would be at $22.65. You add that to the $2.61, the stock today, based on this math, at the low end of the peer group, and again, we think the '07 dividend is the better way to look at the company, would be $25.26.

If we were to be valued off our '07 dividend compared to where these peer group companies are trading relative to their '07 dividend yield, the share of stock you're left with would be worth $28.36, that's what the math indicates today. You'd have your $2.61 E&P dividend and you'd have a value today of $31.97.

If we were to be compared with the best-in-class platform, which we clearly believe we should be, based on, as I said, the breadth of the platform, the ROE profile of the business and the growth, we're much more similar to the best-in-class company. Again, you have the $2.61 E&P dividend. If you value us relative to best in class off our '06 dividend yield, it's $26.03 after E&P dividend for a total of $28.64, and if you value us off of the '07 dividend, it's 33, plus the 2.61 or $35.61. So, again, we're typically not in the business of advising where we think our stock should trade, but obviously as part of a significant transaction like this, we did a lot of work, the board did a lot of work and we had financial advisers who did a lot of work, and the math indicates that these are the numbers.

And so this is what we mean by unlocking shareholder value. We've seen a little bit of that this week and we believe there's a lot more to come. So, again, this REIT election is about a few things. It's consistent with our business plan. It allows the business to be more competitive in certain of our chosen markets. It preserves the existing strength of the business and it unlocks significant shareholder value. And I think the full extent of that unlocking of shareholder value, if you will, will be realized when we're truly viewed best in class, which we think we are, because of the returns of the business, the breadth of the platform, which should make it more predictable, the funding strategy, the business strategy, and the fact that the business has no interest rate risk. So that's the REIT.

The second announcement we made on Monday was about our reserves. And the obvious question, the question we received many times, is why are we changing our reserves now. Well, to answer that question, we have to go back to the IPO. At the time we took this company public, we had had no losses, but we knew we would have losses, and we knew there were losses inherent in the portfolio. They just hadn't been realized yet.

So what we did was we developed a reserve methodology that was sensitive to mix of business and it was sensitive to how the business was performing. But we also committed to updating that based on data, because we actually didn't have any data at the time, to inform us as to where the losses should be, and also based on other kind of qualitative kind of judgments we would make, and also by looking at peers and continuing to do a comparable analysis, and that's simply what we're doing here today,

or what we announced on Monday, is we're fulfilling that commitment to continue to look t this and make changes we deem appropriate.

And what we've laid down on this page is what the new reserve factors are, and we're comparing them to the historical losses by line of business, and I'll talk about historical losses in a minute, but you see for our cash flow lending business, we are currently reserving, as of the end of August, because that's when this went into effect, at 300 basis points, compared to historical losses of 151. For our senior real estate business, we're reserving at 100 basis points, compared to historical losses of 34 basis points.

And for our asset-based business, we're reserving at 25 basis points compared to historical losses of 18. So the current serves are 142 on a blended basis, compared to historical losses of 69. That will result in a one-time charge of about $30 million to rebalance the portfolio to get them to these numbers. The historical loss data comes from what we view as an important and meaningful pool, but probably a pool that doesn't tell the whole story.

The pool that I'm referring to is the pool of loans that have been paid off since inception of the company, and it's about 2.4 billion. These are loans that have been paid off as part of some resolution and there's been a loss associated with it. So this is a little less than half the current portfolio size. The pool is actually very similar to the current portfolio in terms of average loan rating and in terms of kind of weighted average live, weighted average coupon, et cetera. And you can see by line of business, in our cash flow business, we've originated $2.7 billion of loans since inception, 809 of them have paid off, either at par or with a loss, and the losses have been $12 million for a loss rate of 1.51%, and the new reserve factors are running at about two times that.

In our real estate business, 2.3 billion of originations, $850 million of payoffs, $3 million of losses, 34 bps of historical losses, 1% reserve factor going forward, and for the asset-based business, $2.2 billion of originations, 700 million of paid off loans, 1 million of losses, 18 basis points as the loss factor. And comparing that to the - I mean, 18 basis points of your historical loss, comparing that to a loss factor of 25 days.

Credit, what we're detailing on this page is the most relevant credit statistics for the business. Clearly, what we devised in the past as the amount of accrual is the most relevant. The amount of accruals have been moving up for the first few quarters of this year, and starting with last quarter. They started to stabilize from the June 30 quarter. They're about flat at the end of August relative to June 30. We've broken down non-accruals by line of business. Our non-accruals for our cash flow business are a little over 3%.

Compare that to our reserve level at 3%. That reflects the fact that we view our cash flow business as having the lowest recoveries. Our real estate business has non-accruals of 2.7% and we have reserves of 100 basis points, reflecting the high recoveries we view in our real estate business. And, finally, our asset-based business, with 89 basis points of non-accruals and 25 basis points of reserves, reflecting the very high nature of recoveries we're expecting in the asset-based business.

So, to summarize the reserve policy one-time adjustment, taking it from 88 to 142, and the current credit picture is very stable. Non-accruals have stabilized quarter to quarter and we're projecting charge-offs of 50 basis points going forward. So, a lot of information there, updating on the REIT election, why we think it makes sense, and then talking about reserves.

We thought that this would be a good point to take a step back and answer questions on these two very important announcements that we made on Monday to make sure everyone is following where we are and why we think it makes tremendous sense. So, if I could have questions now, and then we'll move on to the next phase of the presentation.

Josh. We're going to put the questions - ask you to say them in the mike so that the Webcast can pick them up.

Unidentified Audience Member

Sure, thanks, John. Question with respect to the QRS. Are there some loan categories, non-real estate loans, that you'll put in that 25% bucket that might be more profitable than other loans to really maximize the value of the REIT subsidiary.

John Delaney - *CapitalSource - Chairman and CEO*

Yes. The question relates to the qualifying REIT subsidiary. Since that is the entity that doesn't pay tax, how do you maximize that and stay within the spirit and specifics of the REIT regulations. Well, the first thing you do is you fill up the real estate bucket with true real estate loans. We have two businesses that originate real estate loans. We have our healthcare business that makes first mortgages. It's the leading business doing what it does in the industry, and we have a structured finance business that offers a whole variety of straight real estate products. Those are easy.

Some of them are securitized, so we have to put them in the taxable REIT subsidiary, but a bunch of them are on our balance sheet and not securitized and all the new ones going forward will go into the qualifying REIT subsidiary. And then we can maximize the 25% bucket, and clearly it makes sense to put the higher-spread business in the 25% bucket, and we will try to do that, because then we can not be paying tax on higher-spread assets, and we intend to do that. But the other observation I want to make, within that real estate bucket - within the 75% real estate bucket - we can put asset-based loans that are secured by real estate collateral, and we have a fair amount of that.

We have a rediscount business that largely lends to real estate lenders. AL would fit, we believe, in the qualified REIT subsidiary. And then may of our asset-based products, where we're simply lending to businesses, we often get real estate as collateral for those loans. You can actually kind of take out the piece of the loan that's secured by real estate and put it in the qualifying REIT subsidiary, so you can break the loan out and put the piece that's secured by real estate in the qualified REIT subsidiary and put the remaining piece in the taxable REIT subsidiary.

Our guidance is somewhat clued with respect to our ability to maximize this. As you'd expect, we're being reasonably conservative about our ability to do that. I would expect our intelligence around this concept will increase over time and we'll be better able to maximize it, but we're trying to be prudent with respect to what we could do with it at this point.

Andy, I think you had a question.

Unidentified Audience Member

I have two questions, really. First, I don't understand ...

John Delaney - *CapitalSource - Chairman and CEO*

Microphone, I'm sorry.

Unidentified Audience Member

Two questions. First, the TRS, which gets included in the corporate, the 25% bucket, as a corporate asset, is that carried as sort of an equity stub? Because your TRS has to be included in your qualified REIT sub investments, correct?

John Delaney - *CapitalSource - Chairman and CEO*

That's right.

Unidentified Audience Member

And is it carried as the full asset load, or is it just carried as the quote, "equity stub," the equity value.

Unidentified Company Representative

Right. The REIT sets are based on you value the assets of the REIT, and so the REIT's assets in this case would be the real estate loans that has the select corporate loans that John talked about, and also its investment in the TRS. So it's not the full amount of assets in the TRS, but basically just the equity value of that investment.

Unidentified Audience Member

And then the obvious question, obviously you addressed this internally with your own accounting and legal professionals, but is this going to wave a red flag in front of the IRS and do you think you'll run into a lot of push back, or where are the politics on this?

John Delaney - *CapitalSource - Chairman and CEO*

We don't believe this will raise any red flags with the IRS. We've obviously had very sophisticated tax counsel advise us on this, both at our legal firms and our accounting firms. I think the intent of the REIT rules are to allow entities to hold real estate assets in a very efficient fashion, which does a variety of things. It lowers the cost of real estate, which was deemed positive, and it allows individual investors to invest in real estate securities.

And we're taking advantage of that, as a REIT, with our real estate assets. The assets that are not deemed to be worthy of this protection we put in the taxable REIT subsidiary and we pay full tax. CapitalSource will actually be a pretty good-sized taxpayer. We're modeling that we'll pay 21% effective income tax in 2006, which is not inconsequential, so there will be a fair amount of tax being paid by that taxable REIT subsidiary.

So it's our view that this is consistent with the law, and to the extent it's worth deciding whether it's consistent with the spirit, we think it is.

Joel? I'm sorry.

Unidentified Audience Member

Can you talk a little bit about how this will affect the assets that are going into your CDOs and whether that will change the amount of issuance you will do?

John Delaney - *CapitalSource - Chairman and CEO*

I don't think it will change the amount of issuance that we do materially. I think we might become more of an unsecured borrower on a relative basis going forward. We had always considered ourselves migrating to unsecured debt. This might accelerate that a little bit. But I think it will change the mix. I think what we'll tend to do is financial real estate asset separately and then corporate asset separately.

When you finance a real estate with a corporate asset, it makes the real estate asset a bad asset. It gets dragged into the taxable REIT subsidiary. So it's clearly more efficient to do real estate assets in their own vehicle so that they can fit neatly in a qualified

REIT subsidiary. So we'll change that. But, again, we've looked at that and we don't think that's material. In some ways, it's more consistent with the way the market finances these assets anyhow.

Joel, I think you had a question.

Unidentified Audience Member

Thanks. Maybe on page 18 you could talk a little bit about what went into the assumptions behind the revised reserve factors. If you look at the duration of the 151, I mean, annualized losses are obviously a lot lower than that, and your coverage ratios would be three to four times annualized losses, which are substantially higher than any bank or commercial finance company that I'm aware of. So maybe if you could talk about the methodology and the thought process behind studying those factors.

John Delaney - *CapitalSource - Chairman and CEO*

Sure. Obviously, our position is that the reserves accurately reflect the losses that are inherent in the portfolio, both known and unknown. When we evaluated what the reserve factors should be, we certainly looked at the data. The data is meaningful. It's 2.4 billion of loans, it's very similar to the current portfolio. I don't say it completely informs us as to what the levels should be. I think maybe in five or 10 years our data will completely inform us in terms of what the reserve factors will be, but I think it's certainly material.

What we also took into consideration are the qualitative factors that you'd expect us to consider, and we also looked at comparables, which we view as an appropriate thing to do. And, based on our judgment and kind of summarizing all those factors, which is a very indirect answer to your question, we came up with these being the right levels.

I don't know if Tom you'd anything to that?

Tom Fink - *CapitalSource - CFO*

No, I think that answers the question.

John Delaney - *CapitalSource - Chairman and CEO*

Bob?

Unidentified Audience Member

Two questions, maybe a follow-up on Joel's question. Would you say then that the revised factors that you have are essentially equivalent to static pool loss rates for each of those products?

John Delaney - *CapitalSource - Chairman and CEO*

I don't think we have enough data to do the kind of - we can do static pool data, but it moves around, because there's so much lumpiness, so you have a bunch of pools that have no losses, then you have a pool that actually has a loss and there was only four other loans in the pool. Depending how you slice this, the losses are huge.

So I think it's our view, and Don Cole, who was really responsible for most of the data, would share my opinion that the static pool was not statistically significant at this point. I'm getting a head nod, so I'm assuming he shares the view. But we saw up to

this point this one pool of liquidating loans, 2.4 billion, which is meaningful, does inform the decision, but again it's not the only thing we're looking at.

Unidentified Audience Member

Second question, on the E&P dividend, when will you decide how much cash and how much stock, and are you essentially leaning towards close to the minimum amount of cash, as you've laid out in examples?

John Delaney - *CapitalSource - Chairman and CEO*

Yes, we will decide before the end of the year, and certainly I would think we won't wait until the end of the year, so I think we'll decide in the next few months. I would think around our earnings announcement would be a logical time for us to maybe talk specifically about this, but we're not committing to that at this point. And we're looking at a variety of kind of corporate finance factors to decide what's the best thing to do, and that's probably the only answer I can give you, because we actually don't know. I don't know exactly what it is right now as I stand here, so if we did, we would tell you.

Unidentified Audience Member

Okay.

John Delaney - *CapitalSource - Chairman and CEO*

Michael?

Unidentified Audience Member

Two questions. First, in terms of the '07 outlook, I was hoping you'd give us a sense of what the effective tax rate that you're anticipating might be, I assume it's obviously going to be lower than the 21%, but if you had a ballpark.

John Delaney - *CapitalSource - Chairman and CEO*

Low to mid teens.

Unidentified Audience Member

Okay, and then, just in terms of your thoughts on the payout ratio, it sounds like you're looking to really pay out 100% of the earnings even though you have the flexibility to pay out less, and I'm just wondering, why not pay out a little bit less? And then, just lastly, if you could just update us on the bank and how this fits into the overall equation.

John Delaney - *CapitalSource - Chairman and CEO*

The question, I think I answered the first half of the question. The second question is about the payout ratio.

Unidentified Audience Member

Actually, you didn't give us a rate. I said in here ...

John Delaney - *CapitalSource - Chairman and CEO*

Low to mid teens is kind of what we're forecasting now. And the second question related to payout ratio. I think at this point our view is that we will be paying out close to our EPS. We haven't provided specific guidance for EPS yet, which we will.

Unidentified Audience Member

And the thought is that that's a cash payout, or to move the stock dividend?

John Delaney - *CapitalSource - Chairman and CEO*

Our view is that it's cash. And, again, we'll have more guidance around exact EPS numbers soon, but our view is that the dividend will be made in cash. We have the flexibility - one of the things about this structure is we could elect to not pay out the earnings in the TRS should we decide to do that. We're substantially reflected by the tax rate we're paying, but our view at this point is we'll be paying those out. And your last question related to the bank.

One of the things that we looked at among the many diligence items we had to complete - and for those of who are not familiar with what Michael's referring to is we announced our intention to obtain a Utah industrial loan corporation charter, which we would principally use to finance kind of our corporate assets was our view, particularly the asset-based loans. It's a more efficient source of funding for the asset-based loans. It's a specialty charter that's really designed for use by a finance company as opposed to kind of a retail bank business.

And we believe, by housing the Utah industrial loan corporation, or the bank, within the taxable REIT subsidiary, that would work fine. We don't have the approval of the bank yet, so I can't say that we know for sure that that's the case, because we don't even have the bank yet, but all of our analysis and diligence and questioning and looking at this indicates to us that we'll be able to do that. And to the extent - and the bank is very important to us - to the extent that that was an issue, that would have caused us to pause, potentially, on this strategy. So it was an important issue that we looked at.

Yes, sir. Up top, back row.

Unidentified Audience Member

Thanks. Can I just check on page 14 the math at the bottom of the page, the 2.15 and the dilution to the 1.96.

John Delaney - *CapitalSource - Chairman and CEO*

This question sounds like the math is wrong.

Unidentified Audience Member

So I just wanted to check.

John Delaney - *CapitalSource - Chairman and CEO*

I was going to come and unplug the computer.

Unidentified Audience Member

No, I'm assuming it's correct, but I just wanted to check your assumption. Is that adjusting only for the dilutive effect of the E&P dividend ...

John Delaney - *CapitalSource - Chairman and CEO*

Yes.

Unidentified Audience Member

... and not any capital raisings in '06?

John Delaney - *CapitalSource - Chairman and CEO*

No, there are capital ...

Unidentified Audience Member

My understanding was that you were going to raise capital independently of having to fund the cash portion of E&P business as well to sustain the business. That's not included in the dilutive effect for the 1.96.

John Delaney - *CapitalSource - Chairman and CEO*

In this model - let me try to take a step back and make sure we're on the same page. Our models and all of the numbers we've provided have a capital raise in '05 and one in '06. This assumes that the capital raise in '05 has occurred, because the share count at the bottom is 134 million shares, so you can see in that footnote if you can see it down there, and now we're about 118, 119, and so that's in it, first of all. And then, secondly, the reason that it goes from 2.15 to 1.96 and from 2.90 to 2.67, is the effective of the E&P, which includes the dilutive effect of the stock, which is 75%, and then the dilutive effect of raising that cash portion, which is in that 134 number.

So in that 134 is capital to grow the business, and you'd argue capital to pay the 25% E&P.

Unidentified Company Representative

Is this working? The dividends that we're talking about for both '06 and '07 reflect a 2005 equity raise that John just spoke to that will get our year-end shares outstanding to 134. It will reflect a 2006 equity offering that John spoke about earlier as well, and spoke to on the phone call on Monday, of north of $600 million of new equity, and it also includes the effect of the E&P dividend that's going to be distributed at the beginning of 2006. So all of the dilutive effects of all of the equity offerings and distributions we contemplate between now and the end of 2006 are in the '06 number.

Likewise, any equity we contemplate in the 2007 period is in the 2007 number.

Unidentified Audience Member

Great, thank you very much.

Unidentified Company Representative

So all dilutive effects are in there.

John Delaney - *CapitalSource - Chairman and CEO*

Don? This gentleman's next. You may want to give him the mike.

Unidentified Audience Member

John, assuming that with the new reserve factors that the entire provision hits in the quarter in which you originate a loan, does that mean that senior real estate lending and cash flow lending would actually be unprofitable in the quarter in which you originate those loans?

John Delaney - *CapitalSource - Chairman and CEO*

It's kind of on the day in the quarter and the spread in the loan. I think we can safely assume that if it's originated in the last week of the quarter, it is, because depending upon the spread of the loan, if it's originated in the beginning of the quarter, you could make up for it.

Unidentified Audience Member

And then, second question about the REIT election, your '07, when you model out '07, do you think you've completely optimized the TRS and the QRS by then and that the dividend guidance you're giving for '07 is a good run - the growth going forward will be the growth of the business, not more optimization in '08?

John Delaney - *CapitalSource - Chairman and CEO*

I think the key point here - it's a good question. I mean, let's go back to the comp page for a second, if I can figure out the right direction here. These businesses are all utilizing the efficiencies inherent in the structure, obviously, so there's no kind of jump in their EPS based on their ability to better utilize their structure, which is not the case with CapitalSource - '06, as I've used the term, is a lagging dividend, because we can't maximize the structure, '07, we do feel like we're maximizing the structure. I mean, maximizing it to the extent of our current knowledge, which will obviously improve, and our sophistication around this issue will improve.

We think we understand it very well, kind of from a downside scenario in terms of how we utilize the structure. So that's why we're having such a significant bump in dividend, is because just the passage of time, which I think was your question. So '07 better reflects how we think the business will perform.

Unidentified Audience Member

Hi, excuse me. I just wanted to clarify, in 2005, potential capital raise, it looks like the shares you guys are putting out there is just enough to cover the entire E&P dividend. So, if there is a capital raise, would you just be raising the cash portion?

John Delaney - *CapitalSource - Chairman and CEO*

You mean 18 million shares ...

Unidentified Audience Member

Fifty million shares, I would assume that some portion of that is simply the stock dividend, and some portion is ...

Unidentified Company Representative

That is not related to the stock dividend, okay, so that the 134, again, that is just equity contemplated to run our basic business outside of the dividend related to the E&P. So the money raised by those approximately 15 million shares ...

Unidentified Audience Member

It's actually a $300 million and some odd ...

Unidentified Company Representative

That's right, in addition not.

Unidentified Audience Member

Right, and then on top of that, at January 31, or whenever that date is, whatever portion the stock dividend will increase the shares as well.

Unidentified Company Representative

Yes, that is correct.

Unidentified Audience Member

Thank you.

John Delaney - *CapitalSource - Chairman and CEO*

Other questions? Phil.

Unidentified Audience Member

I noticed that Fitch put you on watch yesterday. In terms of leverage of the business, the four to one, what kind of dialogue did you have with the rating agencies? Is there room for that? I mean, I understand that Fitch was more of a defensive measure on their part. There wasn't anything ominous in there, but can you leverage this more, or is it not desirable based on what you guys look at, kind of prudent business practices.

John Delaney - *CapitalSource - Chairman and CEO*

Well, we've always wanted to keep a solid margin of safety in our balance sheet, which meant that we would never leverage it up to the full extent of the assets. If you look at the profile of our assets, which is 95% senior secured, and the credit performance of the assets, which has been very good, there is no question that these assets could be leveraged at a higher rate than we leverage them. There's lots of examples of companies who leverage these assets much higher than we do, and if you look at the leverage we obtained in our securitization transactions off these assets, it's much higher. So we could certainly push leverage. We don't think it's prudent. We think we're generating good returns at a more modest leverage level.

We think it's a further hedge on being a REIT and paying out our dividends, building in that margin of safety so that we can be more opportunistic about when we raise capital. So I think that - I mean, if anything, it is my sense that over time the REIT election will gently move leverage down, and saying as a C-corp would have probably moved it up, just because of the efficiencies in terms of the equity cost of capital. We don't have to leverage the business as high to drop returns.

In the near term, there's no material change in our view on leverage. We've kind of guided to 4.5 and under, and that's where we are now. But I think your question is could we leverage these assets more. The answer to that is yes. All of the classes we have, whether they be real estate, asset based or corporate, and there's examples of independent companies that doing it. Obviously, banks leverage them much higher , and the capital markets leverage them higher.

Tom is going to talk a little bit about leveraged guidance by business group, but I don't know if that would answer your question.

Unidentified Audience Member

What about with respect to getting investment grade rating someday, is that still a goal?

John Delaney - *CapitalSource - Chairman and CEO*

Yes. It's clearly a goal. We have one now, it's just from one of the agencies, and as you indicated, Fitch did put us on negative watch, which wasn't a complete surprise to us because of this change, and I think they rightly want to make sure we can execute this change, and execution is always the biggest challenge in these businesses, and they want to see us execute in this new structure, which is a very fair position for them to take.

We're confident we will, and we're confident after several quarters of execution, then we'll be back to where we were and moving the other way. So it is clearly our goal to move up the investment grade ladder, if you will, not just with the one agency that is rating us now, but with the others as well.

Tom, I don't know if you ...

Tom Fink - *CapitalSource - CFO*

No, I agree with everything you said, John, and we will talk about leverage. I'll touch on that a little bit in my remarks, but I think as we view the business, it's entirely consistent with what we've said in the past, and even what Fitch talked about in their release about being within the - for our core products, within the four to five times range.

John Delaney - *CapitalSource - Chairman and CEO*

David?

Unidentified Audience Member

Thanks. Still some things I'm confused about. So, going forward, you want to be provisioning at a level such that the loan loss reserve is maintained at a 1.42% of ending loans, is that right?

John Delaney - *CapitalSource - Chairman and CEO*

It's our sense that the reserves will stay at these levels. We will continue to look at data, continue to review these qualitative factors and make decisions about where they should be, which is what they're required to do, but it's our sense that we'll stay at these levels.

Unidentified Audience Member

Okay, and then going back to Joel's first question, in terms of the cumulative losses by line of business ...

John Delaney - *CapitalSource - Chairman and CEO*

Yes.

Unidentified Audience Member

... can you disaggregate that back to what an expected annualized loss by line of business is? What is the right charge-off rate for each of those businesses, realizing that you can't predict the future.

John Delaney - *CapitalSource - Chairman and CEO*

Well, I think we can all agree that we can't predict the future. I mean, if you were to take these 1.5, 34 and 18 and assume that the weighted average life of our portfolio is about 2.5 years, you start getting a sense as to what the annual losses could be. But our guidance for charge-offs is 50 basis points.

Unidentified Audience Member

Okay, and do you disaggregate that by business line?

Jason Fish - *CapitalSource - President*

We have not to date.

John Delaney - *CapitalSource - Chairman and CEO*

I was confirming Jason's answer. We have not to date. The timing was bad on that.

Unidentified Audience Member

And maybe in Bryan's presentation, although I didn't see it in here, will you be getting into the aging of the non-accrual loan by line of business and the inflows and outflows of that, or the impaired loan level?

Jason Fish - *CapitalSource - President*

No, we weren't going to be going into that level of detail today.

John Delaney - *CapitalSource - Chairman and CEO*

We've talked in the past about how the different types of loans kind of present themselves differently once they're in the non-accrual category, meaning asset-based loans tend to go in and then out quickly, because the resolution tends to be a very dramatic, hard foreclosure, liquidation approach. The cash flow loans stay in the categories longer, either because things are good or because things are not good, meaning if they're good, and the business is righting itself, typically it will stay as an impaired loan for some time, even if the trends are positive, because you stay with the company.

And if it's not good, the work outs take a long time, because your source of repayment is through the business, not through the liquidation of its assets. And so you're either turning around the business or getting in a position to be sold, and those take time. So we haven't provided specific answers, but the anecdotal answer is the cash flow loans stay in there a long time and the asset-based loans tend to go in and then out. And real estate is somewhere in the middle.

I mean, we've had situations in real estate loans where they stay in a while, because we're actually quite comfortable with them staying in there. We're very secure, we're getting paid a default rate, the equity and the meds may be fighting, we have a senior loan, and we'd rather sit and get paid 500 basis points more of default interest, even though it's past maturity and it becomes a delinquent loan, obviously.

Sometimes real estate loans stay in these categories because we're moving towards foreclosure and the borrower files for bankruptcy, which stays the foreclosure. Depending upon the state, it can stay it a long time or some states are more progressive and allow lenders to foreclose faster. So it's - I would say like a lot of things, the real estate is somewhere in the middle. ABL tends to be quick, cash flow tends to sit around for a while and real estate is somewhere in the middle.

Unidentified Audience Member

Okay, thanks.

John Delaney - *CapitalSource - Chairman and CEO*

And then Henry will be next.

Unidentified Audience Member

Do you guys contemplate a higher after-tax ROE with the new structure, or is it just going to generate additional growth? Obviously, you guys are contemplating additional growth, but will you also generate a higher after-tax ROE?

John Delaney - *CapitalSource - Chairman and CEO*

Yes, we will. The business was running at an after-tax ROE of about 17% for the first half of the year. Our models indicate that for 2006, that the return on equity in the business will be 20% plus, so we'll be higher after tax model.

Henry.

Unidentified Audience Member

Is there a survivor bias, obviously, with these numbers? You've got good loans pay off and bad loans stay on the books, and so how do you ...

John Delaney - *CapitalSource - Chairman and CEO*

Unfortunately, that happens. Yes, I mean, there is some of that. There's some adverse selection, which is one of the reasons we think the data doesn't completely inform our answer. We're not reserving at 69 basis points. We're reserving at a higher number, because we think that what you're talking about is real. I mean, we've assessed that, and a lot of very good loans also stay on the books for a variety of reasons, lockouts that we have, et cetera, that Joe is going to talk about this in his business, the corporate finance business, Joe Kenary.

There's a substantial percentage of his portfolio that's at very low leverage levels, and the borrowers just choose not to refinance this out, either because they have plans of selling the business soon and it's just not worth it, or because we have large prepayment fees, or they're just working on other things, and we stay in there with the borrowers. We also proactively keep these borrowers by lowering the rates and doing other things to keep the borrowers.

I mean, I think it's an appropriate observation and we've taken it into consideration, but I don't think there's any other conclusion that you could draw from there.

John, we'll do you next, but let's do that gentleman first. He had his hand up.

Sameer Gokhale - *Bear Stearns - Analyst*

Thanks. Sameer Gokhale from Bear Stearns. I had a question about your capital raises now that you've changed the structure of your business, do you raise capital looking out at foreign commitments, maybe six months out, or do you raise capital and then figure out where to deploy it in terms of making loans, and then how sophisticated is your client base now that you've changed your structure? Do you think that exposes you, perhaps, to clients thinking you have to deploy that capital somewhere so they could take advantage of that from a pricing perspective and try to squeeze you out for a lower-margin loan? How would you think about that? Thank you.

John Delaney - *CapitalSource - Chairman and CEO*

Sure. No, I don't think our clients' psychology as it relates to their relationship with us is at all informed by our capital-raising needs. Sometimes, we're shocked how little our clients care about us and what we are or what we do. Like when we started the business, you'd think a lot of them would ask, do you have the money? And not many of them did.

So if they didn't ask it then, they're probably not going to ask it now. So, I think as it relates to how we'll raise capital in the future - as I said to an answer, I think Joe's question, we keep a fair amount of margin of safety in the balance sheet. We could leverage the business more if need be. We can retain earnings in taxable REIT subsidiary if need be. We keep excess capacity of a significant degree in our credit facilities. We've always kind of run scared of liquidity to some extent, and we run our business and built our business that way.

As it relates to the capital needs of this company, we're not concerned about this structure requiring us to raise additional capital. We've always viewed the capital markets, to quote someone I had dinner with last night, it's more opportunity constrained than capital constrained, and we think that applies to our business. If we think we have good opportunities and we're producing the kind of returns that we have delivered, that there will be ample sources of capital to finance the growth of the business.

And that this move allows us to give our capital to our shareholders, and as we need more, if they like what we're doing, they'll give it to us.

Unidentified Audience Member

Just a point of clarification on a previous question. I understand that there's no reason to think that the reserve factors change, but I'm assuming, if real estate is going to be a leader in your growth, if the 142 is going to come down at some point ...

John Delaney - *CapitalSource - Chairman and CEO*

Yes, that's a good point. I should have been more clear on that. As we should, we do look at our reserves by line of business, and so the answer I think I gave earlier is it's our sense they'll stay at these levels. It is our sense they'll stay at (inaudible), so as the mix of business changes between real estate and corporate and asset based, you'll see changes there based on that. I should have made that more clear, Don, thank you.

Okay, I'm going to use that pause as an opportunity to keep going here. So I'm going to talk just briefly about the business, just kind of frame it up and then turn it over to Jason who will go through some statistics and talk in detail about the guidance. The business, and, again, this is going to be under the category of refresher, because most of you are familiar with this. We really have four divisions in the company.

We have three lending businesses and a captive forensic and due diligence audit subsidiary. Our corporate finance business, senior debt to finance middle market leveraged buyouts. Our healthcare and specialty finance business is a collection of asset-based lending products. Healthcare focus, clearly, real estate and accounts receivable, but also security alarm finance and something called business credit services, which is an exciting growth engine of the company that Dean will talk about in more detail.

Our structured finance business provides two products, real estate lending and rediscount finance, which is providing financing to smaller finance companies, and a decent percentage of that business is real estate. Those are the three lending businesses, and they're enhanced through CapitalAnalytics business, which is a captive forensic due diligence firm. CapitalSource basically owns an accounting firm that's oriented towards doing due diligence for lenders. It's got 70-plus professionals. Most of them are CPAs and they help us create good credit outcomes.

All of these businesses share kind of several common attributes, not only our entrepreneurial culture, but their orientation is to offer value-added lending products. CapitalSource is generally financing one of three things, an acquisition, growth or recapitalization transactions. These are all high value add situations and this is where we get paid premium for the level of service we deliver. We think our businesses are market leaders. They benefit from sustainable competitive advantages, which is the teams that we've built.

Again, going back a little bit to talk about some of our comparables, we have 450 people. We're doing direct origination, direct underwriting. A lot of the comparable set of companies is more passive buyers of structured products in the market. It's a very different business model, and they all share a common operating model, which is very intensive, and Bryan will talk about this in more detail, as he should, but I'm just going to highlight for you a few things. Number one, loans within CapitalSource really go through kind of a dual-track underwriting.

The business groups, each of these three business groups, have development officers who find the deals. They have investment officers who structure and underwrite the deals, and then they have loan officers who manage the deals on a going forward basis. CapitalAnalytics, 70-plus professionals, reports to Bryan independent of these business groups. They are engaged in all of our underwritings to do some form of diligence analysis. And their professionals have to support a deal, both during the initial writing and on the approval process, and then they also go in on a quarterly basis to audit the customers and detect

problems early in the performance of these businesses. From a strategic standpoint, as I said, we focused on these kind of high value-added products. All of our lending products generally are focused on businesses that require greater expertise and are in markets that are inherently less liquid. And it's the intersection of this high expertise, low liquidity, where we find the highest-risk adjusted returns.

We're not expecting this to change as part of this new election. Again, this is taking a great business and positioning it to be a better business, and all of the strategic focus will continue. And the obvious question people always ask us is how do we get such high returns, with very high credit outcomes and very good credit outcomes? It's because of our focus. We focus on situations. As I said, when you're financing an acquisition, growth or recapitalization. Our lending relationships with our customers tend to be short, two to four years. We tend to have a fair amount of turnover in our portfolio, which results in the acceleration of Ts (ph), and we believe in addition to financing the specific needs of the borrower, we're providing some level of service in terms of helping them get that transaction done, helping them finance their growth if it gets really fast. Helping them finance an acquisition, helping them finance a recapitalization.

So that's the reason, and we keep making this point, why we earn such high returns, because we're in very complicated, high-touch situations. Some of the situations we go in are very positive. Some of the situations we go in are negative. A lot of restructurings, recapitalizations are part of broken companies, and they need financing. So we make money both financing growth, positive situations, and we make money going into tough situations with highly structured deals.

And, as I said earlier, we believe we've built the best independent commercial finance company. It's got the right strategic focus, which I just talked about. It's got a broad-based platform. We have no interest rate risk in the business. We deliver a lot of value to our customers and we get paid for that. It's still an entrepreneurial company, and what we just did, this election, has excited this company to a level that I haven't seen it since we started the business. So as we enter chapter two, I feel like we're entering it with the same entrepreneurial drive that we had when we started the business. And now, we also have a tax-efficient structure.

So, with that, I'll let Jason continue.

Jason Fish - *CapitalSource - President*

Thanks, John. I'm going to talk about the current portfolio for a couple of minutes, how we got where we are, and then I'll turn it to guidance for the balance of this year, and then 2006 and 2007. As you can see from this slide, CapitalSource has consistently grown as a portfolio in the last couple of years by no less than $1.5 billion a year in net asset growth. And 2005 year to date has been no exception, and that's with more adverse and different conditions than we've seen in the past.

For one, competition, which I think you've all seen out there, with more lenders entering the fray, has been more aggressive in 2005, and we've really seen this has been about the most lax credit period that we have seen since we started the business in 2000. Debt multiples, specifically in the cash flow area, have increased dramatically and spreads to LIBOR and prime have only narrowed, making the conditions for lending more difficult overall and making us pick our niches much more carefully. Also, the natural maturation of our business and the portfolio, coupled with that easy credit, has resulted in greater run off in the portfolio, coupled with higher prepayments, and John talked about that nature of the prepayments that have come in a little bit.

This is not unexpected. It's going to happen as your portfolio gets older and as you delever or as your clients delever their positions. They can relever, they can sell the business, they can do dividend recaps. But our net growth has remained steady, and we believe it will remain steady and accelerate even further into 2006, with no compromise to the credit standards or the methodology we use to make our loans. And we think the primary reason for that is we've maintained a truly diversified senior debt focus. We have three business groups that complement each other that allow us to deploy resources where there are the best risk-adjusted returns, and these are our group presidents. We'll talk about those later. We also have three principal lending products. We have a senior secured asset-based loan, senior secured cash flow loan and first mortgage loan.

To a lesser extent, we have always made some mezzanine loans. They remain a small part of the portfolio. And you can see that we've had a demonstrable move over the last year in the first half of '05 versus the first half of '06, towards the asset-based and first mortgage loans, away from the cash flow lending, reflecting where we view the right point to be is at this point in the credit cycle.

Our franchise strength continues to grow. Fully a third of the loans that we've closed this year come from either existing clients or sponsors of CapitalSource. The balance derived from the diverse group of sources that we have marketed to over the last several years and who are all aware of the CapitalSource name, our products and our reputation for quality underwriting and the ability to close loans efficiently and in a timely manner.

A broad footprint has created a strong and growing pipeline of deals that we have seen and we proposed, and as you can see, every quarter for the last several that we depict on this page we've seen more prospects than meet our initial screen, and we've issued more term sheets, with the exception of a slight dip in the fourth quarter of '04. Still, in the first half of the year, we have seen a record number of term sheets issued.

Our process and our deal selectivity has maintained a remarkable consistency. As you can see, our screen prospects year over year have gone up 40%, our term sheet executed has gone up 45%, and our deal selectivity has come down to now just 4.5%, meaning that the number of loans that we close relative to the prospects that pass our initial screens are only 4.5%. And I'll come back to this slide in a couple of minutes.

The result is a compelling economic model for shareholders, consistent with where we said we would be when we went public. We have grown to the high pretax return on equity we had established as our goal back in August of 2003 when we went public and back when we were trading with a mid-teens pretax return on equity. For the second quarter, our pretax return on equity was 29.3%. And we did this basically the way we said we would.

We had greater operating efficiencies in the business as the balance of the pool, or the balance of our assets, have grown. And we have grown from an underleveraged business at slightly more than one to one levered at the time we went public to a business at our stabilized leverage level of between four to one and five to one debt to equity. And we have broadened the franchise while producing higher returns on equity than both commercial finance companies in our universe today and the commercial REIT universe we're going to be compared to in the future.

So where does this performance lead us going forward? Our guidance for 2005, as John said on Monday, is $1.35 per share, and I know there's been some confusion about the per share counts. I'm going to try to go through this incredibly slowly. We do anticipate, to the third and fourth bullet point up there, that we will do an equity raise between now and the end of the year and it may be sooner rather than later. We're still working with our advisers on that, but we will do an equity raise independent of the earnings and profits dividend that we're going to issue.

That number is factored into both our '05 guidance numbers and our '06 and '07 guidance numbers. The '05 guidance numbers also take into effect the almost $30 million provision that we're taking as we adjust our new reserve policy this year and going forward. It's the equivalent of guidance of $1.53 if we had not taken this $30 million reserve. For 2006, our guidance, as John said, is $2.15 before the E&P dividend, $1.96 after the E&P dividend, which is $2.61 per share, and now I'll get into the details of basically what we think we're going to do in our core products and our core metrics for the business. And I'm distinguishing between the core products and the other products, and I'll get back to that in a couple of minutes.

In our core products, which is the business that we do today, is our asset-based lending. It's our first mortgage lending, it's our cash flow lending. We think that average loans that we're projecting in 2006 will be $7.3 billion, and that compares with average loans this year that we gave you at our last investor conference of about $5 billion, and that's a bigger jump in average assets than you've seen the last couple of years. And we actually have a reason for that.

As John was saying, we have grown into some new products, specifically in the asset-based lending category, an group called business credit services, which reports through Dean Graham, who will talk about that in a few minutes. That business has come online this year and it's building a lot of momentum and we see that momentum continuing even stronger into 2006. In addition, and Mike Szwajkowski will talk about this in our regular real estate lending, our non-healthcare lending, we have doubled the size of our real estate, this group, this year.

In part, that was brought to bear because we brought in a new head of real estate this year, and he was charged with growing that group, okay. That group is now starting to fire, and again, think that they are going to be making incremental loans in '06 to the run rate that they are on right now, and those are two of the principal drivers of why we think they'll have a higher average assets on which we'll earn in 2006, relative to what you've seen in terms of our growth over the last couple of years.

And I said I'd go back to this slide. I just want to point out, another reason why we think that we're going to have substantial incremental growth in 2007, and that reason is that we do see, and we have seen in the second half of this year, a slowdown in the large number of prepayments that we saw in our business in the first half of the year. And just by way of example, the deals closed, which is the fourth line down there, in the first eight months of 2004, were $2.8 billion. Now, that's commitments. That's not funded loans. This year, we're up almost $800 million from that at $3.6 billion. That said, in the first half of 2004, we funded in excess of $900 million of funded loans. This year, in the first half of the year, we funded on an incremental net basis just about $500 million of loans.

What it says is, A, we had more prepayments coming in this year, offsetting some of the new growth. Number two is that there's a lot more momentum in terms of organic growth that could potentially come down the pike later this year and into '06 from the existing balance sheet. Getting back to the guidance, the average yield of 11.5% is pretty consistent with what we've done. We still maintain that we will see our spreads narrowing. We have a little bit this year. As we broaden our platform, we have provided for the fact that we will see further narrowing of spread in certain businesses.

That's being offset, obviously, by the rate hikes that we've seen over the last 18 months. Our other income, at 60 basis points, that we project for '06 is basically in line with this year, which is where we forecast about 50 basis points, and it's going to come from the same basic areas, which is agency business, primarily related to our HUD loan activity, as well as equity gains on equity positions in our portfolio we get from making some of our loans or co-investments, as well as a line called due diligence deposits forfeited, which are due diligence deposits we take in on deals that don't come to fruition.

There is an offset line item in our operating expenses. It's always been there, but that's how we get to 60 basis points on the other income. Our cost of funds, at 4.8%, Tom will talk about how he's continued to drive down our cost of funds relative to LIBOR, but LIBOR keeps going up, and that's why we're projecting 4.8%.

Our blended tax rate John has talked about, because we had to put so many assets in the taxable REIT subsidiary, we'll be at 21% for 2006. We see that trending down to the mid to low teens in 2007, and we think over time one of the big things that will help us is bringing more efficiency to the tax structure of the REIT.

Our average leverage for next year we think is going to be at four to one, consistent with where we are today. We're a little higher than that today, and again, we're going to raise our annual charge-offs estimates to about 50 basis points, and that's just on a dollar basis. We had given guidance that we would have about $20 million in charge-offs for 2005 and we think that we will still hit that number. Our assumptions for 2006 is that we're going to have about $42 million of charge-offs. In other words, we put into our numbers - we're not saying we're going to have it, we hope we don't, but we put $42 million of charge-offs into our numbers in addition to the increment to our general reserve.

The non-core products that we put on are basically going to be real estate related products, not terribly high yielding, certainly incredibly safe and with no interest rate risk and basically put on to make sure that we comply with plenty of space with the REIT regulations so we conform on a tax basis. We don't expect them to have a meaningful impact on income statement for 2006, although they may have a more meaningful impact on the balance sheet.

The capital raise, John talked about this on Monday and again today. We anticipate an additional $630 million of equity coming onto the balance sheet. Those dilutive effects are in the 2006 and 2007 numbers. We have looked at it a variety of ways, whether we do it in two offerings or three offerings, or various block trades over the course of the year, and we just sort of blended that in terms of figuring out the dilution effects. But we're anticipating about 630 million of equity raised next year.

Two-thousand-seven, we're guiding to a $2.90 dividend. We've talked about this a bunch. It goes down to 2.67 with the E&P dividend taken into account, and we see really that growth coming from two areas in 2007. Continued growth in our basic businesses, probably the rollouts of some new related products as we get more comfortable in the REIT structure and figure out what we can do under this structure that we may not see today, and also bringing greater efficiency to the tax model, and specifically as we show here, moving some of those real estate assets that are currently in our bond deals that are trapped in the TRS. Going forward, they will move out of the TRS as those bonds come due.

With that, I'll stop on guidance and we will again open it up for more questions.

Bob Napoli.

Bob Napoli - *Piper Jaffray - Analyst*

Jason, what are you seeing competitively - what do you think is driving the slowdown in prepayments, and when you gave, I guess, the assets outstanding for the third quarter at the end of August, you had nominal growth over the end of the June, but you obviously seem very confident in a significant acceleration.

Jason Fish - *CapitalSource - President*

Yes, what we're seeing, in terms of the prepayments, I think what we saw at the end of the year, there was a tremendous amount of new entrants into the market in terms of banks coming in, and the equity markets were pretty hot, too. So we saw a bunch, especially of the leveraged buyouts that we had financed, either doing dividend recaps or selling their businesses, and that was really driving the prepayments.

It wasn't like people had a $10 million loan from us and they were taking that away for 50 basis points to go to another lender. So it was really we were seeing a lot of transactions that caused loans to pay off, mostly in the form of larger recaps where much more money was raised, and that was really because people would go - if somebody took a loan from us and it was at 2.5 times EBITDA and it had been two years out, it might be down to 1.5 times EBITDA. And the market was offering them four or 4.5, and we couldn't compete, or we wouldn't compete, a that kind of a leverage multiple, and so the loans went away.

I think a lot of that activity really has - the easy activity in that regard has played itself out, and so companies that had performed very well or not as well, but had the opportunity to sell their businesses, there was a lot of that activity in the first half of the year. I think we've seen across the board, and Joe Kenary specifically can talk to it, a slowdown in general LBO activity in the middle market in terms of those types of deals.

And then the second question is on?

Bob Napoli - *Piper Jaffray - Analyst*

Just on the non-core assets, the FHA assets or whatever else you need for the REIT qualification, are there going to be billions of dollars of those assets? What are we talking about?

Jason Fish - *CapitalSource - President*

We're still working though the numbers on that. There potentially could be a couple of billion dollars coming on in trades that we'll do over the course of the next few quarters. But we're still trying to figure out what is the most efficient way to do that.

Bob Napoli - *Piper Jaffray - Analyst*

And the goal there is to maximize the amount of non-real estate assets that you can put into the REIT so you're doing those assets to ...

Jason Fish - *CapitalSource - President*

It's just there are a whole variety of compliance issues that our have to make sure that you make and we just want to make sure that we have both on an asset test and an income test, we are well within the bounds on real estate.

Bob Napoli - *Piper Jaffray - Analyst*

Thanks.

Jason Fish - *CapitalSource - President*

Joel?

Unidentified Audience Member

Jason, the senior cash flow was down at (ph) 30%. Do you guys, when you look at our models, what realistically are we looking at as we move into '06? I mean, how low could that possibly go?

Jason Fish - *CapitalSource - President*

Well, I think it's probably going to go lower rather than higher. I think that actually, and Joe can talk to this more when he comes up, he's actually seeing a pickup in activity to some degree. So I think on an absolute dollar basis, you'll see greater growth in that area. It's just on a relative basis to the asset-based business that we're doing, obviously the real estate business. It will continue to shrink. Do I think it will go down to 20% of the portfolio? I don't think it will in the near term, no.

John Delaney - *CapitalSource - Chairman and CEO*

One just thing to add to that, the way we look at the business is not so much based on what the percentage of the business that could become, but we have a sense as to how big in absolute dollars that business should be. We think a well-performing corporate finance portfolio, meaning it's still focused on the part of the market we think is less efficient, and increasingly using syndications to sell that exposure and drive returns, which is something we're doing and Joe is going to talk about, that the absolute dollars of that business, it would be hard for it to get more than 3 billion-ish. Because you'll have a lot of managed assets also because you'll have sold that in pieces of assets, so you may be managing 3 billion. You see what I mean, so I think we tend to think of that a little more - so there's a fair amount of growth.

You could almost double. But I think that unless we changed market focus, it should stay in that range. And the rest of the business will continue to grow, so everything around it will be getting bigger, so it will go down as a percentage, but the business

in and of itself could probably almost double in size, and then probably, depending on the cycle, move up and down, hit that ceiling and then come down again.

Unidentified Audience Member

I've got a housekeeping question that might be better suited for Tom. If I understand it correctly, your provision in excess of credit losses is excluded from taxable income, so when you put out our dividend and earnings guidance, are your plans to pay out 100% of taxable income, and is that delta big enough that the dividend could be actually greater than the GAAP income, or how are you kind of thinking through that?

Jason Fish - *CapitalSource - President*

Well, I think you're correct, Don, that there is a book tax difference here and that the REIT requirements are to pay out at least 90% of your income as defined by the tax code, not necessarily by GAAP, and provision for loan loss is not a deduction from taxable income. An actual charge-off would be, so we would have an adjustment to our GAAP earnings for that. And we're - I think it's commonplace for REITs to have some non-GAAP measures, either an adjusted EPS, or I think in the equity world, more of a funds flow from operations concept.

I think we'll look at putting something together to help out on that regard for people. But, yes, I think what we've modeled is paying out close to 100% of the income for tax purposes.

John Delaney - *CapitalSource - Chairman and CEO*

I'm sorry, Michael, go ahead.

Unidentified Audience Member

Sure. I was hoping you'd give us a little more detail around your expense expectations and staffing. It seems like, at least in the core products, you're talking about a 50% step up in the loan book, and if I understand the '07 guidance right, it's another 3 billion, so a near doubling in assets in two years. Maybe, you could just give us a little color about how those ratios should evolve.

Unidentified Company Representative

Sure, I think in the year we've talked about roughly a 2.5% operating expense to assets range for CapitalSource's business by the end of 2005. We've tried to be prudent as we've looked at the business going forward, recognizing we'll have additional expenses in running the business in terms of just being a larger business, but also additional expertise and things that we'll be hiring as we grow the business going forward. What we've tried to model is a little bit of conservatism in terms of the core products of the business, but then you consider all of the additional real estate assets and things that Jason was talking about, but I think that they would come on with probably much, much less incremental expense.

So we still expect to see our operating expense as a percentage of assets to come down over time. I don't have a number for you, because we're still working through some of the forecasting and budgeting for '05 - excuse me, for '06 and beyond, but I think we'd definitely get to numbers less than 2% by the end of '06.

Unidentified Audience Member

And just the loan size, does it go up substantially, or it's basically the same kind of tiers of loan sizes that you've been dealing with?

Jason Fish - *CapitalSource - President*

Well, we've seen the slight uptick, I think, in the loan size and I think Dean Graham will talk to it specifically. In his group, there's been a tremendous amount of granularity in the AR loans that we've done there, and those have ticked up, but from about a $3.5 million average size to about a $5.5 million average size. So it's not exactly going into very large loans.

In terms of as we plan out the metrics for loan officers and loan administration, which is really the area where we don't have any economies of scale, we're still looking at the same number of loans sort of that we have today in terms of every time we have another dozen or so relationships, we bring on another loan team.

Does that answer ...

Unidentified Audience Member

That was, and just a clarification on the prior question about the charge-off. Does your dividend guidance - is it just based on charge-offs, or does it include the provision in excess of charge-offs?

Unidentified Company Representative

It's just the charge-offs. I mean, the simple way to model it is you would add back to our GAAP income the provisioning and then subtract out the charge-offs.

Unidentified Audience Member

Okay, so the whole change and reserve methodology is actually not impacting the dividend outlook at all.

Unidentified Company Representative

I would say our new reserve policy is fully baked into our dividend guidance, and all the booked differences associated therewith.

Unidentified Audience Member

Okay, thank you.

Unidentified Audience Member

Two questions. Can you talk about what you think the cyclical nature of prepayment fees are? You referenced earlier that your prepayment fees can bounce around if one of your companies get bought out. Rates come down and they prepay, and I'm just curious what is the perfect scenario for prepayment fees, what's the perfect environment and what's sort of the worst environment for prepayment fees. I mean, obviously loans you made a couple years ago, rates came down, in theory people were refinancing. That's good for prepayment fees. In theory, the equity market went up, and there was a lot of M&A activity. That's also good for prepayment fees.

So I'm just curious, of rates go up and the equity market slows down and M&A activity doesn't happen, is that all bad for prepayment fees?

John Delaney Rates generally aren't that relevant to prepayments in our business because of the nature of what we do, which is to finance typically a relationship of a couple of years, financings from event, and borrowers typically don't look to refinance as rates move one way or the other. What did you refer to clearly applies, which is M&A activity, and really liquidity. Because when there's a fair amount of liquidity in the market, which as Jason alluded to occurred in the beginning of this year, it drives up kind of multiples in terms of what people are willing to pay for businesses, not that they necessarily should, but with more leverage, they feel comfortable paying more.

So financial sponsors who own companies that we finance in our core finance group generally put those companies for sale. We see situations where people buy a business, a year later, they want to sell it and other people hold them longer. But you see a lot of M&A activity, and for us it's actually a fair amount of financial sponsor to financial sponsor activity, one private equity firm selling a business to another. And so liquidity in the markets we think drives M&A activity, which drives prepayments. That's probably the number one driver of prepayments. And so it does become cyclical, obviously, as liquidity backs up.

People tend to sit on their companies longer and you have less M&A activity and less prepayments. This year is a pretty good environment for prepayment activities for that reason, but it's not as much rate related, as you might see with a residential mortgage company, for example.

Unidentified Company Representative

One other, if I could just amplify that. Just to remind people, when we take in prepayment fees and we model, we continue to model about 50 basis points in prepayment fees, and we've seen better than that this year, there are two components of that. One is if there is an actual exit fee or success fee or early termination fee associated with a loan, that gets paid and that's a cash payment at the time the loan is due.

The other is, when we take in fees up front, we may have a commitment fee up front, and an exit fee. That's just standard. Regardless of when you get out of the loan, you might have one up, one out, and if you have an early prepayment at one point. Those fees, both the front end, and then the back end, which are contractual obligations of the borrower, will get amortized into the loan over the life. If the loan pays off early, and most loans pay off early because either companies delever, or in the case of transitional real estate, the transition gets completed. When they pay off, there are prepayment fees associated with that loan just by the acceleration of that discount. So just bear that in mind, too. And that's - we feel very comfortable that the steady state of 50 basis points is primarily encompassed in that number.

Unidentified Audience Member

Just one more additional, and really a question - John, in your presentation you talked about other aspects of the real estate business that you can now get into, some of which may be institutionalized, that you couldn't do before. If you looked at the old structure and what you thought your asset growth would be over the next five years, and you look at the new structure, can you compare and contrast what you think the five-year growth rate will look like going forward under the new structure versus the old structure and how much the complexion of assets may look different under the old structure and the new structure.

John Delaney - *CapitalSource - Chairman and CEO*

Okay, I can't give you exact percentages. We haven't modeled it out five years. It will clearly be higher, and I think - let me go through where we have expansion opportunities. In our healthcare business, we have two new products - really three new

products - that we will really offer to our customers. First, we will offer a fixed - let me take one step back further. We have a real estate lending business within our healthcare business, that provides first mortgages secured by nursing homes, assisted living and other healthcare real estate, and we think we're the leader in that business. There's three things we're not doing right now.

One, providing an overly attractive floating rate product. We have a floating rate product, but, again, it's modeled to hit our return thresholds and now we can model our return thresholds at a different model because we don't have to include the tax. So trying to get high teens, close to 20 after tax, now we can go in without the tax factor and try to get high teens, close to 20. So we think that will allow us to do some more institutional-quality business. In other words, there's a lot of private equity firms and real estate opportunity funds who are making investments in the healthcare area, and we really haven't been able to provide and lead some of those financings, and we've had the opportunity to do it. We haven't been able to do it.

So that's on the floating rate side. We'll also be able to offer a fixed-rate product. We've seen a nice opportunity to be a fixed rate lender in the healthcare sector, unsecured by the real estate. But after kind of the cost of hedging, because we don't have any interest rate risk, we couldn't make our returns work. Now we can. And the team is just incredibly excited about that product, in particular. And then the third product is a sale leaseback product, which is kind of a hybrid form of financing. It's very prevalent in the asset space. We actually buy the asset and lease it back to the operator, and it works well for certain types of operators who don't want the real estate on the balance sheet.

And we have a fellow who runs our healthcare real estate business named Jim Pieczynski, who used to be the president of a successful healthcare REIT, and he's played in all those products. He and his team are very excited about this, so there's an opportunity for product expansion, leveraging the expertise we have. Don't need any new origination efforts, really don't need any new credit, skills. We may need more people to handle the volume, but the core competency is there, and it's really good, and so they're really excited about that. So there's an example of some of the things we can do.

And then you flip over to the structured finance business, which has two businesses. It's got a rediscount business where we lend to real estate lenders. We're rediscounting their loans. And then they have a traditional real estate lending business that does short-term, floating-rate lending secured by a variety of asset types. Again, we've been constrained a little bit to do transactions with Carlyle's real estate business, for example, where they're buying larger deals, they're putting more equity in and they want a little tighter pricing. We haven't been able to compete for that business. Now we'll be able to. Again, we've got the marketing machine in place, we've got the core competency. It will give us more business to do through the same platform.

So that's really where a lot of the excitement is coming from, the ability to expand these platforms. The other thing about some of these products - it's the last comment I'll make - is some of them have a longer-term profile, so it actually becomes more efficient in a way from an operating expense, because if you do a good sale leaseback, you're going to own it for 10 years. And so your origination cost, your loan management cost, just become inherently lower because you're not always replacing the asset. So we think there's natural product expansion in two of our businesses that's significant that has the team really excited, that leverages the core competencies and the core originations strengths and will drive more growth.

We haven't quantified that. It's a little bit in our numbers, but actually not a lot, because, again, since we're not doing some of that stuff, we want to be prudent with respect to what we're projecting. But I can tell you, the excitement that the team has, it exceeds what we've modeled into the business at this point.

Unidentified Audience Member

Thank you very much.

Unidentified Audience Member

Do you envision using acquisitions or any other methods to build some of these new businesses, or is this just going to all be organic, built internally?

Jason Fish - *CapitalSource - President*

All the numbers that we gave you are based on internal growth, but I don't think we'd preclude looking at opportunities out there.

So I'll turn over the podium to Bryan Corsini, who will talk to our credit overview. Thank you.

Bryan Corsini - *CapitalSource - Chief Credit Officer and President, CapitalAnalytics*

Good afternoon. I'm Bryan Corsini. I'm the Chief Credit Officer for CapitalSource. I've been with the company since its inception. In addition to being the Chief Credit Officer, I'm the president of the due diligence subsidiary that John talked about, CapitalAnalytics. A lot of the presentation will hone in on our capabilities there and how that matches up and complements the lending groups.

The focus of the discussion, the first item on the list, is the five elements of the underwriting process, and what's interesting is as you go through the slides, most of the slides are virtually identical to previous presentations, which I actually found kind of interesting. One, because my colleagues said you don't have to prepare anything, I can just keep talking about the same thing ...

Unidentified Company Representative

(inaudible - microphone unavailable).

Bryan Corsini - *CapitalSource - Chief Credit Officer and President, CapitalAnalytics*

Very important, and I think that's the key, is things are consistent. We've designed a process I think over the last five years, we've enhanced our capability. We've increased the expertise in terms of from a process perspective, things have been run very consistently, which I think as a result results in consistent credit performance.

And throughout going through these different elements, the other items on the page in terms of talking a little bit about site assessment and capability of the staff, that's basically worked within the presentation. Our first item, disciplined view of debt risk, essentially what we're getting to there is on each and every credit, we do various underwriting analyses to either determine what we feel to be a true marketable value of a customer's collateral or what the enterprise value of the customer's business is, in the case of a cash flow loan. And, again, as I will show you throughout, we have designed a process that is a complement between the work the lending groups do and the work that CapitalAnalytics does, highly tailored and specialized to accomplish just that.

The last item I think on the page is actually a very important highlight, is that our focus on this is to do a very granular, credit-by-credit analysis on each and every transaction. We don't subscribe to a portfolio theory where we feel we could do 10 loans and have an acceptable miss rate, if you will. Again, as we've indicated with our loss reserve statistics and the various non-accruals, we will have losses. Our expectation is to have losses on a go-forward basis on occasion, but we think we've built a business model that, just given the type of deals that we are doing, and in the market space that we're in, to minimize those losses.

Next item, experience, focus and specialized professionals. Actually, maybe I can use the pointer, which I've been dying to do for a long time - it's not working. Push the button. Oh, there we go. We've got all of it. See, inexperience at button pushing. The last four items I think are actually what really highlights the difference on how we do our process.

The first item is looking at a company's industry business model, mandate, et cetera, are pretty much vanilla things that in order to assess a customer to see whether or not it hits your credit criteria, you've got to assess all those things.

The last four items on the page are probably where the most difficulty lies. Given the customer target that we have, that lower, middle-market transactional-oriented business, most being project renewers and in the vast majority of cases, companies aren't public, aren't being followed by credit analysts or have any other public debt, those four items are really the difficult things to figure out. And as I go through here, we'll describe a little bit how we think we've been able to accomplish that.

The next item, more embedded resources in the process. I'm going to flip very quickly to the next page. You don't need to do this, but just to remind everybody, the slide that John went through earlier, we do have a dual track process, which we've run since the inception of the company. We feel it's fully built out, it's a very effective model. We pridefully say we think it's the best in class and a very unique way of running this part of the business. Back to the prior page, and if you look at these two slides, essentially, both units, i.e., CapitalAnalytics and the business unit, do an analysis and do an underwriting of each different credit. Obviously, there's a lot of collaboration that goes on, because we do is we do all this work on a simultaneous basis. Of course, we want to be able to turn the transactions around, and the whole key is to be speed and execution focused.

If you look at what the details, rather, the out product of the two groups, there's a lot of similarities, assessing financial performance, assessing management skills, the client's operational abilities, where you'd begin to deviate a little bit. If you look at the left side of the page, on the CapitalAnalytics focus, they're going into a lot of detail in terms of internal control environment, detailed projection analysis, auditing and validating historical financial performance. And, again, I'll highlight the audit and validate. That's where the staff of predominant existence of CPA types become very valuable. We do a lot of substantive testing. I like to call it, for the CPAs in the audience, a very balance sheet substantive focus audit, if you will, of the numbers. Because our whole key to making sure that we've made a proper evaluation of a customer's cash flow or expected future collateral performance is to make sure we really understand what's behind the numbers, the reporting, the validity of the numbers.

So, as an example, substantive testing on accounts receivable is really understanding the revenue cycle, understanding a company's cash flow and the key is the hindrance of what you believe to be the cash flow. Another item is balance sheet analysis, looking at offsets, looking at cost accounting issues. As an example, items that should be part of the cost of sales, being comfortable that the borrower's cost accounting system fully absorbs those costs and puts them to the P&L versus holding them up on the balance sheet in terms of adding them back to the inventory cost, thus potentially inflating the EBITDA.

It's that kind of capability that we believe allows us to isolate the different credit risks for these borrowers, and, truly, what we disclose in the first page is really try to box what we think is either the enterprise value or the collateral value, which is really the basis for making the loan. We drill in and do a lot of sensitivity analysis to really understand what that valuation is, and then structure a loan at a discount to that value.

And then back to this page, the check and balance, which allow for controlled growth, and this obviously is an important page. It shows up two different times in the presentation, and the highlight here is that CapitalAnalytics function again reports directly up to the Chief Credit Officer. It does not report to the business units, and the reason for that is obviously from a control perspective, if there are issues that are developed or highlighted on the forensic audit side, those items are basically flushed up to the credit side of the house and become pretty visible pretty quickly and it really rolls back into the business units, so these items are dealt with, whether in terms of a structural deviation on a proposed loan, some kind of reduced funding. On occasion, loans, we decide no longer to pursue. And I think as Jason indicated, probably the non-leverageable piece of this pie is looking at the loan officer side. As you begin to build your portfolio, we have various metrics in place in terms of how many loans we think each loan officer should be able to handle, depending on the business unit, as well as the product within the unit.

And that is the piece that really grows. On the CapitalAnalytics side, obviously we add field examination personnel and forensic accountants, but the way we have the business structured is those fees that are generated from doing that work are passed back on to the customers. So much like if we were doing an underwriting and we decided to go out to a third-party public accounting firm or a field exam specialist, typically those fees are passed along to the customer at close on an ongoing basis as part of the overall loan servicing. We charge those fees and retain them, which defers the cost of having this captive staff in house.

Last slide on the elements is CapitalAnalytics being at the core of the credit process. Again, to highlight, we have - and there's a slight typo, for which I apologize. We have over 70 professionals. As John indicated, a vast majority or CPAs. If you would actually roll in folks who are both CFAs, JDs, MBAs, CPAs, you end up having about 95% of the staff having some type of professional delegation. The way we've organized the staff is to mirror the work and the specialization required of the business units. So, as an example, we have resident in-house folks who are experts at doing clinical analysis for nursing homes and understanding various reimbursement laws, both at a federal and a state level. Those folks obviously are highly trained and highly focused on our healthcare portfolio.

We have folks who - real estate specialists focus on the secure alarm space and so on and so on. As we hire our staff, we look for resident expertise based on their experience, and also looking for a core competency in general. Folks who have a talent for forensic and detail auditing and train them to the ranks in order to produce specialized folks to assist the business units in their business.

Then the other highlights, reporting directly to the Chief Credit Officer, customizing things in (ph) the group. And I think the last item, get to use the pointer one last time. I think the whole advantage, really, is the quality and consistency, and I think the other issue here is control. And what we mean by control, it allows us to be very flexible and customize the approach of our work, depending on the situation at hand. So, as an example, if we find ourselves in a situation where we're attempting to do some kind of a cash flow or enterprise value loan and we're having a difficult time assessing the sustainability and the quality of earnings.

And, oftentimes, we have gone into those situations, we've been able to structure an asset-based facility with maybe some type of a bridge on the enterprise value piece until a tranche (ph) is able to either repair or replace personnel to do what they have to do on the systems from the earnings side. And having that capability captive and in house allows you to literally change your scope and your concentration on the fly, which is a much more unwieldy process, if you will, if you were trying to outsource all that work. And, again, I think it clearly is a big advantage, again, given the market space that we're in where we're dealing with entrepreneurs, transactions that are generally transactional. Pardon the redundancy. But transactional in natures - companies, again, non-public, et cetera.

And the last piece that I'm going to cover, and this was a question earlier in terms of looking at our loss reserves. I think the key, at least, that I like to focus on is the levels of non-accruals, which John indicated on a previous slide, appears to have leveled out over the last several quarters. In addition, we do an analysis of the recovery rates on the loans that have gone into the impaired and non-accrual buckets. Since June '03, we've had 21 loans go into these delinquent and non-accrual buckets. Thirteen loans have been resolved, with a net recovery of 89%, and as indicated, the asset-based side and the real estate side are a little bit more predictable and generally gives you a higher recovery rate. That being said, I think on the senior cash flow slide, an 80% recovery rate, at least based on my experience over the last 20 years, is actually fairly high.

I think to address another question that we had earlier, I mean, obviously, as you look to build up reserves and on a go-forward basis, your intuition is to say that loans that are left in the portfolio possibly have a higher rate of - or higher risk of loss. I mean, at this juncture we haven't done any analysis that indicates that that's going to be the case. But just given the other factors, industry comps, lags on the losses, et cetera. That's how we came up with the reserve factors that we currently have.

Again, key takeaway on credit is we've maintained our standards. The five elements - again, I've gone over them several times over the last several years. We've enhanced that system, we believe. We've built a better mousetrap and we've continuously worked, just through execution, on enhancing that capability.

The recurring audit work, as I mentioned, is a very important factor to allow the business units to assess their own portfolios with a backstop of on-the-ground field examination, detailed analysis of the borrower's books and records. The portfolio review procedure is really a company-wide sort of look at the entire portfolio, and that's done at various levels. I mean, on a weekly basis, there's a lot of touching in terms of the high-profile situation developing in the portfolio. We do, as we mentioned, on a very frequently recurring basis go out and reaudit those customers. Quarterly portfolio meetings, monthly portfolio meetings in terms of looking at a watch list and things of that nature.

And I think kind of going back to the slide that shows us dual process, I think one key that that allows us to do, the way I look at this, it really gives the business units the flexibility and the ability to be very creative on the lending side, knowing they have the backstop of a capable, detailed sort of forensic group of people who are going to help them uncover and identify various underwriting issue that the accountant orientation type of folks would more readily pick up, and in addition be able to supplement their own loan management on a go-forward basis. And I believe that was the last slide, so questions?

Questions?

Joel? Sorry.

Unidentified Audience Member

Bryan, I think most people would recognize, perhaps management would agree, that the risk here is senior cash flow loans. Recovery rates have been very good. Under perhaps a less liquid environment, less M&A, what would you kind of mentally think about in terms of recovery rates, normalizing it through a cycle?

Bryan Corsini - *CapitalSource - Chief Credit Officer and President, CapitalAnalytics*

Well, I mean, our own experience here is I don't really believe that a frothy liquid M&A market has actually helped us out of any of the situations, because our view has been is when loans go bad, they're bad for some reason. And typically what we have found is there's been some kind of an execution problem, whether it's management, whether it's a change in equity sponsors made to a business. So, typically, those loans end up going into a resolution phase where we're not getting full recovery.

Typically, businesses, for whatever reason, people may put a value on them, or put a value at some type of a discount, thus the excess. I don't believe, and of course someone will prove me wrong - I can think of really one case where we actually had a layered tranche of debt behind us, we were actually able to buy up the rest of the senior tranche and kind of push them a step up to take our position out. That might be the one case I can think of. It was probably due to maybe a frothy lending environment, if you will, but anecdotally I can think back just over all the years, I haven't really seen a situation where you say, we're in a frothy market, let's pull the plug because the greater fool will come along and buy this company and thus take me out of my position.

So I don't really believe it has a lasting effect. I think as John indicated, these loans are more complex to work out, and I think the whole key for us is an early indication that we have some kind of a problem, whether it's a deviation from expected performance, a sea change in the customer base, a change in management, a breakdown in controls or something like that, and by doing very careful portfolio monitoring and frequent field exams, you're able to really get ahead of the curve, and I almost view that as almost minimizing the impact of the event, versus having a situation where your customer base erodes, cash flow erodes, and by the time you figure that out it's a little too late to do anything.

I don't know if I really answered as directly as you asked.

John Delaney - *CapitalSource - Chairman and CEO*

Well, just to add one other thing to that, I think the thing that we want to make sure people understand, in 2005, and everyone was in agreement with this - Joe Kenary, many of his team, certainly senior management. They viewed the opportunity in that business as not particularly good relative to what it was in prior years. I think many private equity investors would view it as not a very good market for them to be buying companies. And to some extent it's even worse for a lender, because even when it's not a particularly good time to be buying companies, you an have some real winners, but in the lending business, it's either a good loan or a bad loan. There's not a winner in there.

So I think that that business has been stable, which I think reflects on the discipline that we've shown, which will influence these credit outcomes, because I think that if you look at where deals are getting done in the market right now, it's at very high multiples in terms of what people are paying and in terms of what people are lending. So I think we've been disciplined this year also, as it relates to this M&A market.

Unidentified Audience Member

Just to follow-up, if you were to look at your vintages, say, '04 and '05 corporate cash flow loans, debt to EBITDA, given your selectivity, would it be a whole lot different than '02 and '03?

John Delaney - *CapitalSource - Chairman and CEO*

Joe's got a whole slide on that, showing the debt to EBITDA by period. They're not materially different. They have moved around. There were times that they were very low, I mean, too low, really. There's a standard that we have, and as long as it's at standard - if it's below, great, but if it's at standard, we'll do it. They have moved around, but within the kind of ranges that you'd expect.

Unidentified Audience Member

Thanks.

Bryan Corsini - *CapitalSource - Chief Credit Officer and President, CapitalAnalytics*

I don't know who's first. Sorry.

Unidentified Audience Member

Thank you. Bryan, I just wondered, how do you feel about the portfolio today compared to what you would have expected it to be when you originated - when business was originated. There has been an uptick in non-accrual loans. Where do you see non-accrual loans moving as - in, say, '06? And then I was wondering, just as a follow-up, do an overview of how you feel about the portfolio, maybe you could give a case study on one of the loans that's received a lot of attention, the World Health, and how you got involved in that and how you get into that situation and how you get out of it.

Bryan Corsini - *CapitalSource - Chief Credit Officer and President, CapitalAnalytics*

I think there's about three different questions. One, head on, is in terms of being able to predict what the level or amount of accruals are going to be in the future, I mean, candidly, it's a very difficult thing to predict. I think in terms of the current performance of the portfolio, it is my belief it's hit about what we expected it to be in terms of non-accruals, delinquencies, and charge-offs. But, again, in terms of trying to predict those levels, they're going to move around. I mean, as John indicated, we

could have a situation where something falls into an impaired bucket by being delinquent, but we're in a senior position, charging default interest. We'd like to actually change those loans because you make an extra 500 bps just because the borrower is in default. So you're going to have things move around in these statistics that may or may not really tell you a true story of how we feel about the portfolio.

In terms of World Health, I mean, World Health, I look at that deal as being not that dissimilar to hundreds of other deals we've actually done. The big difference is it's a public company, so everything that happens, everybody in the world finds out about what you're doing. But, given the status of the credit, the structure of the credit and our expectation of the outcome, I really don't view that any differently as, again, hundreds of other loans that we've done. And there was a third question in there which has now escaped my mind, because I'm talking too much, and I apologize.

Unidentified Audience Member

I think you answered all the questions. Thanks.

Unidentified Audience Member

What about the issue of fraud? I mean, in the last five years, essentially since you started this business, there's been some major cases of fraud within your sort of logical, targeted zone. How do you manage around that? How has it affected any of these 21 loans? How big of a problem is it?

Bryan Corsini - *CapitalSource - Chief Credit Officer and President, CapitalAnalytics*

I mean, how you handle it, as we talked about through some of the slides, I mean, the whole key I think is the upfront diligence, and by that I mean you've really got to understand not only what are current borrowers' financial statements are telling you, but how they actually can structure those financial statements. So really reviewing the internal control environment around the accumulation of the financial data, putting together a borrowing base, how accounts receivables are booked, sales are booked. We do a lot of substantive, detailed testing around that, which honestly our scope isn't really designed to detect fraud, but the scope is so detailed in nature, fraud generally - you become aware of fraud as you move through.

Now, having said that, we have had some instances where we've had fraud. Typically, the classic fraud, if you will, especially when you have an asset-based loan, is money is collected through a lockbox, applied to the loan, applied to the collateral and then restored back to the borrowing base. The classic fraud is the money doesn't make it to the lockbox and the borrower keeps it and puts it through their operating account. We have had a couple of those instances. In general what it has been is not money disappearing outside the company, going offshore, or doing some crazy thing, which might be a lot of fun to talk about. It's typically they put it in their operating accounts to keep the vendors off their back.

And when you have those situations, again, the whole key is a crisp loan servicing platform, which we have built, which we do have, supplemented by the audit functions. We don't have a situation where the auditors go out and say, gee, the moneys aren't going to the lockbox and it's been going on for five months and nobody knew about it. That, in my view, would sort of be a disaster. What we typically have is the loan officers on a very routine, detailed basis, tracking the performance of the collateral, and as a result you start looking at collateral trends.

And, again, the simple thing is you'll see an accounts receivable aging where maybe the aging looks like it's not deteriorating, but the collections have slowed down. That mathematically can't be correct, or you may look at availability has been pretty consistent from the borrower, but the rate of cash collections has dropped. And we have visibility into that because we lockbox the collections. Those early indications are rally the key to really not prevent the fraud, because if somebody wants to defraud

you, they'll figure it out. They're running the business, they know much more that's going on much more than we ever are going to know, so if there's some way to circumvent our controls over the loan, they'll figure it out.

The key is the early indication and what I call the carnage control is to find out where you're at, get ahold of the situation before the situation deteriorates any further, and the response is varied. We've had situations where we've had field examiners parked at the customer, and I actually did this a long time ago when I was at one time a field examiner, where you're literally watching the borrower open the mail. Going to the post office, open the mail, watching the postings, get out on the bank, make sure it went where it went. We've had to do that in a couple of instances.

In terms of the losses here in where we have not had a complete recovery, anecdotally I can think of two situations. One where a borrower, actually in terms of the reporting and the cash control, did everything very crisply, but prior to filing a bankruptcy, they kind of circumvented the lockbox a couple of weeks, built up a little war chest. That contributed to some of the loss.

But there hasn't been a lot of it. Because I think the whole key is, as we said, we'd try to flush that out up front, try to make sure we understand the borrowers. And by having this dual-track process, and you have folks on the ground, digging in, we generally can flag a situation or get some evidence of situations fairly early. And, again, I'm being redundant but I think the whole key is the loan servicing, because once you get a loan on the books, you've really got to watch.

Unidentified Audience Member

(inaudible - microphone unavailable).

Bryan Corsini - *CapitalSource - Chief Credit Officer and President, CapitalAnalytics*

In this business, no. What we do, if you think about where would you have fraudulent creation of paper, probably the classic place is consumer notes. But what we've done to safeguard that on the servicing side is we custodian all the notes, we have a third-party backup servicer, and on top of that we audit those customers very frequently. And if you think about in addition to that, there's a very large, what I like to call a phone verification program where we confirm a large percentage of consumer notes being generated from these borrowers.

So the whole key again is to set up the control. We have SBEs. I can actually think of a situation where we weren't defrauded, but a sister company had committed a fraud, literally guys in yellow jackets swooping in and shutting the place down. We had our borrower isolate an SBE, all the notes were custodianed, all the cash was lockboxed, and I believe this occurred on a Friday, and if memory serves, and Mike probably would remember, by Tuesday we had actually sold the position out to a third party. And the reason they were able to move in swiftly, evaluate the business and buy it from us, if everything was in SBE, we could send them into the vault from our third-party custodians, so there's all the notes, here's a ledger, you can check it all. And we had a running analysis of what the cash was every single day, able to isolate the collateral that went with our loan and sell that piece off.

I think where I've seen frauds in the past, literally, is the folks who don't do that, and we've actually - as Jason mentioned, when you have your period of profitable lending environments, we have had customers come to us and say, gee, it's not so much the rate, but XYZ lender and I won't name the names are willing to do the loan without doing a custodian and they don't think they need to control the cash. And we'll convince them that we think otherwise and it makes a lot of sense, but when push comes to shove, those borrowers will just be allowed to leave, and we've had that happen a few times, where in terms of just trying to box that risk we just choose not to take it.

John Delaney - *CapitalSource - Chairman and CEO*

One thing I would add to that, too, is the term fraud has been used a lot, and it means different things. I mean, I've never been involved in a work out when I haven't, or the companies haven't alleged the borrower defrauded us, because why wouldn't you allege that? If you have a problem, there's always some issue in there, and you want to put fear in the company and fear in the people behind the company so that they act appropriately. So the term fraud comes out a lot, and the question is, as Bryan I think appropriately outlined, is it the kind of situation that materially affects our collateral, or is it just bad acts that occur in companies, unfortunately? And I think it's important, because we've had situations where we've alleged fraud in an asset-based situation and we feel like we've been defrauded in some small definition of the word and we will allege it. And we'll push it, and we may take legal action alleging it, and we'll do all types of things to put pressure on a borrower to do the right thing to make us whole.

So I think what Bryan was really getting at is there have been many situations where lenders have truly been defrauded and it's resulted in losses and sometimes massive losses.

We believe, while you can never be completely immune to those kinds of things, that all of the procedures and checks and balances, et cetera, that we do, protect us from that kind of wholesale fraud, which knock wood will never occur, but there will be lots of situations both now and into the future where CapitalSource will be alleging fraud, will be involved in situations that have fraud associated with them, where we lend into situations where it's a turnaround in a broken business. And we're providing financing in our businesses to focus on those types of things, where fraud has been alleged. So I think the term is used very broadly, and the real point is, how does it relate to the lender and how does it translate into the risk of loss in the transaction?

Unidentified Company Representative

This gentleman had his hand up.

Unidentified Audience Member

Hi, I just wanted to be clear that the faster growth is not going to be generated by a loosening of terms or a loosening of credit standards, that it will be generated by a reduction of rates or a little more flexibility in terms of the revenue yield, or something else.

Bryan Corsini - *CapitalSource - Chief Credit Officer and President, CapitalAnalytics*

That statement is correct. We will not relax our credit standards or our methodology. We see businesses that were started in the last year, specifically business credit services, which is a fully asset-based business that's been growing at a very good clip.

We've seen incremental professionals in our real estate group that have contributed immediately and are going to continue to contribute, and that's really where the growth is going to come from. And you're right, if we're going to compete more competitively, not just with newer products or more bodies, it's going to be through having more flexibility because we're going to be judged on a pretax basis now.

Unidentified Audience Member

Bryan, can you talk a little bit about the hiring environment for skilled credit professionals and as the company accelerates its growth going forward, do you envision any challenges supporting that growth, in terms of attracting and retaining enough CapitalAnalytics folks to do the work in the background. And then could you just give us a reminder of how credit analysts are compensated at CapitalSource?

Bryan Corsini - *CapitalSource - Chief Credit Officer and President, CapitalAnalytics*

Well, to address the first question, I can break it up two ways. The retention hasn't been much of an issue at all. We've had pretty low employee attrition, or unwanted attrition, if you will. Having said that, the environment for hiring, and I sort of call out my classic model, where you find somebody, two to three to maybe four-year CPA type of training at a big firm, pull them out, start teaching them credit training skills and try to move them through the ranks. Those people are definitely deciding more difficult to find, and we probably actually compete with our accounting department. I try to stake out by the door and grab their candidates. They're a more valuable commodity than maybe they were four or five years ago.

I think a lot of that has to do with the high degree of this disclosure environment, where being a CPA is a pretty good commodity. So having said that, then say what do you do about that? We've actually started designing training programs, which candidly I haven't had to do before, because we've been lucky in the different cycles, but we're trying to find people, maybe the non-traditional background, maybe a small regional firm.

We just started this fall looking to recruit people maybe straight out of college, and we think we have enough critical mass within the portfolio and there's enough analytical work that needs to be done that you actually have the ability to do some in-house training and bring people along that way. So, at this moment, we've been able to keep up with the demands of the business, keep up with the volume. There have been limited occasions where we've outsourced work, and where we outsource work, I call it more of the routine work. So not that we have a huge asset-based retail portfolio, but to use an example where you might want to go out and do an audit of a retailer that has 100 stores. And you decided for a coverage basis you want to go out and do test counts at 20. We may actually source out the test count piece, which is pretty much low risk, important work, but low execution risk.

So we'll farm out different things where we can get some leverage on the existing staff, which honestly looking back has been an increased incidence but as a percentage hasn't changed all that much. And on the comp question, the entire company's comp is based on salary and discretionary bonus. Our analysts and our underwriters are not pegged to any type of quota, so in other words, you've got to book so many - you've got to be involved with so many fundings per year. Because what ends up happening, if the quota was 10, once those nine were done, that 10th, they're going to try like heck to get that loan in, which is no different than the IOs or the DOs in our business. So the bonus part of that comp, again, being discretionary, is very subjective. And the way we do that, at least on the CapitalAnalytics side, is we run that employee review process just like a big CPA firm would do. We have a lot of loan analysts who may over the year work on different projects, work for different people within the group, and we basically pool the senior people and evaluate everybody collectively. And of course everybody has a direct report and mentor and that type of thing.

So it's fairly qualitative, if you will, because you can really look at the results of the work and just based on work paper techniques and all that kind of granular stuff, we have a good ability to evaluate the performance of the staff.

Unidentified Audience Member

Hi, just a question on the confirmations that you had talked about. For those that might not be familiar with the terminology, that's the process by which you verify with third parties what the assets are of the potential borrower?

Bryan Corsini - *CapitalSource - Chief Credit Officer and President, CapitalAnalytics*

That's correct.

Unidentified Audience Member

Okay, and then in terms of the internal controls testing for a potential borrower, do you - I know some public accounting companies stop doing a lot of internal control testing. What they actually started doing was documenting the internal control procedures, which doesn't seem, to me at least, to give the same level of assurance that actually performing the internal controls tests would do. So do you actually do internal controls testing or documentation or both?

Bryan Corsini - *CapitalSource - Chief Credit Officer and President, CapitalAnalytics*

Well, you've hit it on the head, because documenting what somebody says they do doesn't mean they do it. It's like asking my son if he made his bed before he got in the car to go to school. Unless you verify it, you don't really know if he's actually accomplished that. The way we get comfortable with controls, I'll try not to be too long-winded, but it's really through all the substantive tests that we do.

So, as an example, in every deal you ever do, especially one where you're doing a cash flow loan, you're going got get what I call the dog and pony show, where you sit with the CFO and they tell you this is how everything works, and this is how we control the books, and this is how wonderful our cost accounting system - and we've great planes or whatever the hell system they're using. But then when you start digging around in the details, you really start finding out what's going on. You may find out that the building materials and the cost accounting as an example, hasn't been updated in two years and that the labor rates are wrong and haven't been updated, don't include all the costs, pension, or healthcare or what have you.

So regardless of the control environment and whatever systems they employ, unless you can really go back and on a substantive basis test that, the document really doesn't tell you a whole heck of a lot. So what ends up happening is our folks go in very swiftly, very focused and literally by the end of the week you can go back and say this customer, one, can predict and has been able to report their financial information, or the collateral information. Because it's very important on a collateral basis to do the same thing, and in a very short period of time walk away being comfortable or uncomfortable whether you're going to be able to continue to get reporting in the future.

I was, or I guess technically still am, a CPA, and what the accountants will do is they can tell you they can document what's there and they can document a balance sheet a at point in time. So if it's March, you probably can tell somebody what a December balance sheet should have been, because by then everything's flushed out and you can go backwards and audit it. You've got to have the ability to be comfortable with what the borrowers send us. In some cases, every day is correct, and in order to do that, you've got to be able to do the substantive testing, which again is really the reason why, given the market we find ourselves in and the profile of those customers, you've got to have that in house so you can really customize and drill in where you think the risk points are.

So I can go on and on about this. If you think about LIFO accounting. If somebody has a system to calculate LIFO, whether they do it wrong or write, I sort of don't care. I just want to know that they've made the adjustment with the effective result in cash flow reporting. But having some whiz-bang system to calculate those layers doesn't really do much for me. And having somebody with a great whiz-bang system doesn't necessarily mean it makes me feel better about the loan I'm about to make. So hopefully that helps you.

Unidentified Audience Member

I wonder if you can go back to Bob's question and just clarify the non-accrual question, possibly. You said that you expect non-accruals to move around, but is there any way we can set an expectation that they're going up by some amount? We talked more recent evidence suggests it's flattened, but it seems like the prudent thing to do is to try to give people a sense as to how high it might go in order to try to establish a baseline expectation, not too different than the reserve issue, since we don't really know.

Bryan Corsini - *CapitalSource - Chief Credit Officer and President, CapitalAnalytics*

Well, I mean, again, it's a very difficult question to answer directly, which is probably why I haven't answered it directly. I think a lot has to do with the cycles of the business, and the other thing of course is the mix of the business. If you have a high concentration of asset-based loans and thus you're controlling cash and you're posting your interest to the loan as the loan cycles through, you're going to have much lower incidence of non-accrual loan versus a real estate type of a situation where someone's mailing in that interest check every week. You have a more difficult time controlling it.

So, really, as you go through and look at the way the portfolio is stratified, it is somewhat difficult to predict where those levels are going got be. Is it going to go back down to 1% or go up to 4% is probably your question, and again, at this juncture, it's very difficult to answer that. What I will say is through August we have seen some consistency, i.e., some flattening out of those metrics. What I tend to believe is we're approaching what I believe to be a stabilized situation.

Now, having said that, or non-accruals going to go up 20 bps or go down 20 bps next quarter, it's difficult to predict. There's nothing that I know of today that indicates that that would be the case, but situations change, because you're dealing with borrowers that are operating businesses and things happen in their business that affect their outcome of their cash flow and thus their ability to pay us, which actually there been a lot to report, but hurricane. We had a lot of phone calls when that all happened down in Louisiana, do you have real estate projects that have gotten blown away and you're suddenly going to have a big problem with not collecting interest and principal.

As it turns out, in our particular portfolio, we don't have a lot of concentration. It doesn't appear to be that much of an issue at all, but I'm sure there are other lenders that are big multifamily portfolio in Louisiana, it suddenly has a big non-accrual problem that they probably never could have predicted six months ago. So, again, I'm being evasive and not answering directly, but it's a difficult question to answer directly.

Unidentified Company Representative

I'll be evasive as well, which isn't helpful.

Bryan Corsini - *CapitalSource - Chief Credit Officer and President, CapitalAnalytics*

Thanks.

Unidentified Company Representative

But perhaps if you've had any clarity, I'll try to make sure that it is not clear anymore. I think what Bryan is saying is we're trying to be careful here, because we think that, even though, as I said earlier, we've delivered on everything we said, the one thing we didn't do a particularly good job with respect to is giving guidance to where our non-accruals would go. We were very focused on advising the market that we would have losses, and what we didn't tell people is you'll start seeing some of these credit statistics mature. Because if you go back to the time when we went public, they were all zero. They were clearly going to worsen.

So I think we're very reluctant to say at this point that we think non-accruals are as high as they will go, because they may go higher. I think it's our sense based on some of the trends we're seeing in the business and how things have stabilized that it wouldn't surprise us if they stayed in this range. I don't think we're anticipating any significant spikes up in these statistics, but they could worsen, as Bryan said. So I think we're reluctant to say they won't worsen, but we also have seen some positive trends as it relates to problem loans and things that could go into these categories. I think his words, starting to stabilize, is the right frame of mind we have.

We'll seize that opportunity to take a break. About 10 or 15 minutes, and then we'll get on with the lending groups.

John Delaney - *CapitalSource - Chairman and CEO*

Are we live now? Yeah, I'm just going to get everyone in here. Why don't you bring a chair up here? Hey, Jay (ph), there will always be a chair - Dale, why don't you come on up.

Now we're going to start the phase where we go through the business groups, and I think what we'll do here, just in the interest of time, is let each of the presidents present their group and then we'll open it up for Q&A at the end, which is what I think was our plan, if I recall. So the first person on the agenda is Joe Kenary, the president of our corporate finance business.

Joe Kenary - *CapitalSource - President, Corporate Finance*

Thank you, John. For Corporate Finance, 2005 really represented a validation of the strategy. I think in terms of both our approach and our financial performance and I think the reason for that is really - runs along three seams.

First of all, we have a fully billed platform that has tremendous depth and reach into the market. Second of all I think we've been performing very well and that's really a testament to the great people we have and the tremendous effort they've put in.

And finally, I think it's a very disciplined approach we've taken to the change in the credit markets. I think in terms of looking at the strategic elements of the core business, which really haven't changed, I think, the really has really represented an extension or sort of a continuation of what we do and we focus on primarily are our customers, are private equity firms, primarily the small to medium sized sponsors who we believe are underserved.

We focus on industries in which we believe we have good fundamental and domain expertise. We also have some industry verticals in retail and in the media space. Our products are primarily senior secured cash flow loans. We also have some term B and mezzanine as well, as well as asset-based revolvers, primarily to support the liquidity of our leveraged buyouts.

Our competitive advantages, and this is really where we try to drive when we're working in the market is our ability to execute, our creativity, our flexibility, and primarily our certainty and reputation as a smart lender in the market and I think that's critical and you'll see later why we've been able - our performance, why we've been able to do so well.

Borrower characteristics, I think, and this is something we've continued to hammer on is very strong cash flows, quality of management team and a leading market position. In terms of underwriting structuring I think we continue to focus on low leverage and low loan to value. I think the statistics haven't really changed much and I'll have some slides on that later.

And finally, in terms of competition, I think there's three basic buckets. There's commercial - other commercial finance companies, hedge funds and regional banks.

The industry dynamics of the corporate finance business are fairly straight forward. It's a sponsor-driven business. We primarily rely on sponsors as a recurring source of business and we primarily rely on the areas of expertise to drive our reputation because reputation is very important.

There are three markets - or there's three segments in the corporate finance market. There is the area we really focus on is the lower middle market, which is the $3 to $10 million EBITDA and $10 to $30 million transactions.

I think that that affords us a better opportunity in terms of less competition, less liquidity in the market, and finally, premium pricing.

As I think people have alluded to, this is very prone to the credit cycle. We've seen, I think, the biggest driver of that cycle has been primarily banks, particularly the regional banks. Given the inconsistency, sometimes, of the competitive market, I think, we've tried to be the consistent lender of choice in the middle market and I think the evidence over the past five years is that we've succeeded.

Just a few points to just really emphasize the discipline that we have demonstrated despite the changes in the market. I think if you look at the leverage, our closing leverage excluding the media and asset-based transactions, it remains very consistent without any material deviations.

Loan-to-value, which is another credit statistic we are really focused on. This year I think this statistic is 48%. I think last year at this time we had a statistic that said 51%. I think the change really reflects probably the increase in equity contribution as a result of increased purchase multiples, while we've tried to remain disciplined in terms of what we'll contribute in the transactions.

I think the statistics, though, that really underscore not only the discipline but also the depth of our - our reach into the market and also the quality of the effort to reach into that market are these statistics here and I'd like to focus on a few things.

First of all, in terms of current borrowers, although current borrowers only went up 19, I think that masks the prepayments that I think was alluded to earlier in the presentation. The net new borrowers is something north of 40. Moreover, we've had probably in excess of over $500 million in repayments, yet our loan balance has actually grown 140.

But the most interesting statistic, I think, is when you look at the average borrower balance and you'll see that it's gone down and I think that that's really a testament to the fact that we're continuing to focus on the lower end of middle market and smaller loans where we think CapitalSource can continue to execute on a strategy.

Just a little bit in terms of the competitive environment. I mean, I can continue to bore you with a litany of examples and anecdotes, but I think what I really want to do is highlight a few statistics that I think emphasize what we're saying.

First of all, based on the S&P data that we're seeing, we're really at a peak in terms of credit statistics in the LBO market. Moreover, we're starting to see not only the hedge funds that have come into the market, other commercial finance start ups and regional banks coming into the market, but we're also seeing mezzanine lenders moving into the senior market.

And finally, I think the conventional wisdom is then that while the economy looks somewhat benign, over the last - and everybody thought that maybe the next 12 to 18 months there might be some sort of dislocation in the market, I think nothing we're seeing gives us any reason to think so so we're just moving it forward in terms of business as usual.

So how do we respond to the competitive environment? First of all, I think what we're really trying to do is - one of the things we're doing is trying to leverage our fully built-out platform to really develop other businesses which we think complement our capabilities.

And the first thing we're focusing on is asset management businesses. In Europe, we're trying to - we're building out a team that we think can replicate what our success here in the United States. We're also building out a CDO capability to buy pieces of larger deals that we think will leverage both our credit capabilities and our asset management skills.

And finally, CapitaLogic represents a private equity joint venture that we think can leverage our origination platforms to take advantage of equity opportunities without diluting our core equity focus - our core lending, sorry, focus.

In addition, we're also looking at pursuing larger deals as syndication opportunities. We think this represents in effect, an arbitrage in the liquidity in the market. We will be able to generate fee income, take less risk on the balance sheet, and leverage our execution advantage in the market.

We're also working hard to manage portfolio runoff and I give a lot of credit to our portfolio management team for identifying those quality credits and making sure that they stay within our portfolio and finally and most importantly I think we're continuing to focus on the smaller end of the market, as I said before, with smaller LBOs, being flexible on pricing, yet disciplined on leverage.

And with that focus consistent effort, we've been able to grow the portfolio modestly and continue to focus on complementary businesses that we think will enhance our business over time.

So what are the future trends in corporate finance? I think that as we've mentioned, the enhanced capital markets capability will give us some broader reach and make us a more sophisticated lender in the market and generate substantial fee income.

In addition, the asset management businesses will also generate fee income that should enhance what's already a strong ROE business.

And finally, continue a disciplined investing and underwriting model that I think over the course of the cycle, those benefits will be self-evident and when the opportunity presents itself, the corporate finance business will be well-positioned to attack the market and also take advantage of the inevitable distress (ph) opportunities.

In the interim, we'll continue to adapt to market conditions by focusing on our core business and developing complementary businesses.

With that approach, I am very optimistic about the future. Because as I said from the very beginning we have a fully built-out platform that's performing very well with great people and we will continue to be very disciplined in this current market environment.

Thank you.

Dean Graham - *CapitalSource - President, HealthCare and Specialty Finance*

Thanks, Joe.

My name is Dean Graham and I'm the president of the healthcare and specialty finance business at CapitalSource.

I want to talk to you today a little bit about the healthcare and specialty finance business. Some of the businesses that make up this lending platform. I want to talk generally about some themes that cross over our different lending platforms within this business unit and I want to talk about some specifics relating to each of the specific business units.

The healthcare and specialty finance business is primarily an asset-based business. And consistent with Jason Fish's earlier remarks, as our company has demonstrably moved more toward an asset-based orientation, the healthcare and specialty finance business is today the largest business at CapitalSource. I believe it is approximately 38% of our total funded assets.

The business - the healthcare and specialty finance business is composed of a number of business groups and the I'd like to sort of orient you to these business groups today by dividing them into two categories, if I could.

We have our mature businesses, which have clearly established themselves as market leaders in best-in-class lending sources in their particular markets and we have three other business groups which are in the process of establishing themselves as market leaders in best-in-class lending organizations within their particular spheres and business niches.

All of these business units, whether they're in the healthcare area, whether they're in the healthcare area, whether they're business credit services or whether they're in the security alarm area, have some very similar characteristics which I'd like to discuss briefly.

Essentially, they are all going after the same market opportunity and that is the middle market. You've heard a lot about the middle market today from John and Jason, Bryan and I want to talk a little bit about how that market opportunity affects the healthcare and specialty finance business. Why do we like the middle market? We like the middle market because of its size. We like the middle market because it is traditionally underserved by lenders. We like the middle market because it rewards speed in execution and we like the middle market because it consistently rewards deep domain expertise. When we bring industry knowledge to our particular borrowers, we usually have very good, successful outcomes.

Our products and our specialized credit skills throughout our business units within healthcare and specialty finance are focused on meeting the needs of these borrowers. We have tailored products in both the healthcare, business credit service and security alarm areas and we have specialized credit skills across the board.

Each of the origination teams in these business units is very focused on that particular market. We have deep domain credit expertise within the business unit and within Capital Analytics and we have vast specifically tailored loan capabilities in our loan management side of the business designed to monitor these loans continuously after they're funded.

So let's talk a little bit about the business in general and I thought it might be relevant to show you how the business as a whole has performed over the last 12 months.

The business in general, as you can see, by almost any measure, has enjoyed vast success. Whether you're looking at outstanding - increase of outstanding loans, current borrowers, outstanding commitments, across the board the business has enjoyed tremendous growth. This is a testament, again, to the market that we lend into. It's a testament to our vast origination machine at we've created throughout the company.

Importantly, while we have enjoyed success in these markets, we have also maintained strict credit discipline, a credit first approach, and our average loan size remains well under $6 million, so our portfolio continues to be very diverse and very granular.

Now I'd like to talk a bit about the different businesses and then I'll come back and conclude at the end.

I'd like to divide - as I mentioned in the beginning - the business in to two categories. We have our healthcare businesses, where I'd like to divide this in sort of four categories for ease of discussion. The four healthcare businesses, I'd like to talk about our healthcare credit group, our real estate group, our cash flow group and our mortgage finance group.

All of these businesses, these four businesses within the healthcare and specialty finance business as a whole, have clearly established themselves by any measure as market - as leaders in their - leaders in the healthcare market. We have created, over the last five years, we think, the best in class national origination team. We have the best credit expertise in the business and we think we have the best loan management capabilities in the business.

Turning to each of the specific groups, just to give you a flavor for how they have performed, the healthcare credit group is our receivables group - they - our asset-based receivables group. They generally lend on receivables and inventory to small and middle market healthcare borrowers. Over the last 12 months this group has funded 41 transactions with commitments totaling close to $1 billion.

The transactions that this group consistently wins are broad and diverse. We fund hospitals, we fund long-term acute care facilities, we fund nursing home receivable loans. We fund a vast array of other types of outsourced healthcare businesses.

Introducing some of the highlights, which I'd like to point out, is that we have funded 13 hospital deals in excess of $200 million over the last 12 months. We're clearly the leader in some of the hospital merger and acquisition activity in the United States.

Not only does this business consistently have a consistent pipeline of deals that they close, they also have now distinguished themselves as a group who can do some of the largest deals in the country. And they proved this by successfully winning the Mariner transaction, which was a $1.3 billion deal of which our company participated in the $250 million piece.

The healthcare real estate group, similar to the healthcare group, has enjoyed great success over the last 12 months. The healthcare real estate group, like the healthcare credit group, continues to capitalize on our national origination team and our deep domain expertise and our loan management capabilities. In the last 12 months, they have successfully closed 28 transactions, and that is excluding a large portfolio acquisition, which I will detail in a moment.

These transactions amounted to nearly $750 million in commitments. In addition, the healthcare real estate group funded - won in a very competitive process and then subsequently funded a $227 million portfolio acquisition which consisted of 54 loans and 29 new borrowers.

By any definition, by any measure within their market, the healthcare real estate group at CapitalSource is a leading provider of capital to our facility-based providers within the healthcare world.

The healthcare real estate group is particular excited about our REIT election, as we are going to be offering new products. These products will include fixed rate loans, low leverage loans, and sale leaseback transactions. And we think that bringing these products online will continue to help shape, define and create - enhance the leading platform that the healthcare real estate group currently enjoys.

The healthcare cash flow group within our healthcare business also has enjoyed tremendous success over the last 12 months. It is led by a team - a group of individuals who have worked together for over 10 years and have probably done more of the healthcare cash flow lending than any other group in the country.

Over the last 12 months they have closed seven transactions in excess of $175 million of commitments. The cash flow group, as many of you know, makes senior cash flow loans in the context of sponsors for every class (ph) relating to recaps, mergers and acquisitions and recapitalizations.

Significantly, the group underwrote $120 million transaction which was syndicated over to 10 participants over the course of the last 12 months, which gives you a sense of the breadth and reach of their business.

Lastly, and slightly out of order, is the CapitalSource mortgage finance business, which is on page 63. The mortgage finance business is an excellent complement to our other healthcare product offerings. It is a fee-based business and is primarily related to our healthcare real estate group. As we've said before, the mortgage finance business facilitates HUD refinancing for facility-based borrowers.

In the last 12 months, this business has closed 15 transactions. They closed one of the largest FHA insured section 242 acute care hospital transactions in the country and are currently ranked in the top 10 of HUD lenders in the United States.

All of these businesses, to reiterate, continue to use the same broad-based origination team that we've built out over the last five years. All of these businesses approach their particular market in healthcare with deep domain expertise, both on the credit side and on the loan management side.

Turning to our other businesses that are in the process of becoming leading lenders in their specific niches. I'd like to talk about three groups in particular. These are groups that we have put a lot of effort into over the last 12 months and are very excited about going forward.

All of these groups are in some ways an extension of the healthcare platform in the following sense. They also benefit from the large marketing capabilities that we built out at CapitalSource. They benefit from all of the credit expertise that we have in house and are developing and they also benefit from our enormous loan management capabilities.

So let me start - let me talk about these groups individually to give you a sense of how they are doing. First is the business credit service group. The business credit service group, which we're very excited about, is primarily an asset-based lending group. In the last 12 months, the business credit service group has closed 19 transactions, close to $400 million in commitments and enjoyed tremendous portfolio growth and are currently building out a national footprint.

Recently we've added offices and personnel in Los Angeles, Boston and Atlanta. We believe, like our other businesses that the middle market presents a tremendous opportunity to create customized asset-based solutions for small middle-market borrowers.

The business credit service group is focused exclusively on that market. In less than 18 months, this group has established itself as one of the fast growth engines of our company and we think this business can be one of the largest businesses in our company going forward.

The group currently has approximately 20 people. We think we've already retained some of the best originators and credit personnel in this particular business and I think you'll be hearing a lot more about this in the future.

The second business of the three non-healthcare businesses is the security lending group. The security lending group has focused on providing middle market asset-based solutions to security dealers around the United States. Like healthcare in general, the security lending group focuses on small middle market borrowers where they can provide customized solutions, where they can use speed and execution to tailor customized product offerings and where they can use deep expertise to win deals.

In the last 12 months this group has distinguished itself by closing 17 transactions with over $200 million in commitments. We think actually, today, they are rapidly becoming, if not already, the best in class lending group in the United States in the security loan space.

We have an excellent team of people who have tremendous experience. They are clearly the leaders in their field and we're very excited about the prospects of this group. We're very excited about the prospects of the market, the market size and I think you'll be hearing more about this as we go forward.

Last but not least, I'd like to touch briefly upon the special situations group. As John had mentioned earlier today, we often lend into positive situations using our domain expertise and our loan management capabilities to create positive outcomes and many times we lend into situations that are less positive where we can bring our specialized credit skills also to bear. We can make higher returns primarily in customizing asset-based solutions that make a higher risk adjusted return.

The special situations group is a very good example of this business - of this type of business. Focusing on asset-based solutions, they are creating a leading middle market DIP product and other special opportunities, products, to customize lending solutions for borrowers who need highly structured finance vehicles.

The group is funded in excess of $100 million over the last 12 months and we're very excited about the prospects of their market going forward. Significantly the special situations group has another business as well which is primarily focused in healthcare which is an asset management business. The special situations group has been charged on a number of occasions with conducting the work out activities for other financial institutions, particularly in the healthcare area.

It's a business that we're very good at. It's a business we're very comfortable with and it's a business that other people come to us because of our expertise.

That's a quick look at the different businesses in the healthcare and specialty finance platform in general. Just to recap, we have our mature businesses, which are clearly best in class and over the last five years we think have built a tremendous franchise in healthcare.

The healthcare ABL business, the healthcare real estate business, the healthcare cash flow business and the HUD business we think combine to produce tremendous growth characteristics, the demographic trends in healthcare remain very strong and we think we have the leading franchise in the United States.

Our newer businesses, where we're establishing leading market positions, we're also very excited about. Business credit services, security alarm and special situations, also enjoy tremendous growth opportunities. The middle market into which they lend is very large and the need for capital solutions in these markets is very strong. Speed, execution and industry knowledge, as you've heard Joe talk about and I talked about and you'll hear Mike talk about, continue to distinguish us over traditional banks and other lending sources time and time again.

With that, I will take questions after Mike's finished. Mike?

Michael Szwajkowski - *CapitalSource - President, Structured Finance Group*

Thank you, Dean. Good afternoon, my name is Mike Szwajkowski, I am the president of the structured finance business here.

In the past year we've had a very strong - The past year for us has been a period of strong growth and performance in our business due to a number of factors but some of the things I think you'll hear today from me, anyway, is that the established franchise which we've built over the past five years is really entrenched in the market and paying dividends now.

Our competitive products and I think our posture towards the market is very positive and we've got a deep experienced team which we've built over the last five years and which we're continuing to aggressively build.

So today, structured finance itself, like our other businesses is really a fully built platform which is scaleable and I believe poised for significant and continued growth as we move forward.

Sorry.

Structured finance business is really focused on providing capital to niche segments within two very large financial markets. First, the commercial real estate market and secondly the lender and rediscount finance market.

We do that by emphasizing specific segments and niches within both of these markets which demonstrates strong growth and earnings potential and by doing this we've been able to generate premium risk adjusted returns to the business, principally on senior asset-based transactions. The orientation of the structured finance business is very senior. We have a very small amount of mezzanine or junior loans extended.

We - over the past five years have built what I believe is the premier business within the real estate market and our lender rediscount finance business providing intelligent and I think very highly responsive capital to our clients. Within the real estate finance sector, specifically, CapitalSource today is a leading provider of on balance sheet capital for real estate owners and developers.

We do that by delivering a very broad array of products nationally in scope and targeted at a very diverse array of property types. We're going to continue to broaden that product offering and we're going to continue to do that very aggressively as we go forward, particularly in light of our news (ph).

And of importance, we've continued to build a very strong national originations team. Today we operate coast to coast. We've in fact in the past 12 months doubled our professional staff in the real estate business. We have entered two new markets physically by opening offices in Orlando and also in Chicago and we are also in the process of continuing to expand that footprint to ensure that we have really seamless coverage of the real estate market coast to coast.

Within the lender and rediscount finance business, CapitalSource by any measure is clearly a leader in this highly fragmented and really inefficient market. We've done that over the past five years through consistency, creativity and execution and I believe that that has made us really the first call lender in what is actually a very dynamic and sticky market for us.

And I think if we look at this slide, these figures are illustrative of that. You can see that the number of outstanding loans has increased 41% as of June 30th year over year. Current borrowers have increased by 35% during that same period. Outstanding commitments by 81% and of significance, the outstanding portfolio June 30th had increased 62% to roughly 1.5 billion.

So those are clearly strong growth metrics but what's even more important, I think, is kind of behind these numbers and we'll get to that in a few slides. We've maintained real diversification in this portfolio through both a very disciplined originations effort and our credit first approach to the business.

Within the real estate business itself, our customers and our clients, our developers, owners, investors and most recently we've begun a sale leaseback product so we're targeting also corporate users of real estate and the market opportunity which we've identified is really to provide these creative on-balance sheet solutions and non-commodity solutions to the needs of developers and owners in the real estate market.

We do that by providing highly customized solutions and we are very execution oriented because most of the transactions that we engage in are time sensitive so there is some story around it that makes it a very interesting opportunity and this is really what sets us apart from the market. The products that we deliver are generally intermediate first mortgage debt, senior bridge loans, mezzanine debt and, as I mentioned, sale leaseback transactions.

These are all things that sit well within the CapitalSource framework and our general approach to the market, but to deliver these products in a really thoughtful manner, what we've developed are very specialized credit skills and we've established, I think, now, a very proven regime of underwriting discipline, which is focused on a broad array of things, so it's very hard to summarize in a couple of bullet points, but we've developed proven property analytics, market specific analysis and certainly in understand of our sponsors and clients and all these factors, I think, set us apart from the competition, which can be generally divided into kind of two camps, the commodity lenders and the non-commodity lenders and the commodity lenders are really the kind of (ph) banks and insurance companies, by way of example. We don't truly compete with them on a day to day basis because it's not what we do.

And they represent a significant part of the market. But the non-commodity side of the market where we do compete are the out of the box lenders, which consist really of finance companies, private capital, and recently hedge funds have also entered our business.

And while we do compete with these other parties on kind of a daily basis, we compete on our strengths, which we've developed, improved and established over the past five years so this is where I think the franchise and national reach of our originations effort really pays dividends.

The competitive environment that we face in our real estate business is really not significantly different than it was when we spoke about this last year. Liquidity in the market remains strong across the entire capital structure and while there's ample liquidity there, diverse sources, a lot of the market that's active today competes more on price and to some extent slightly loosening credit with limited in-house origination capabilities beyond that.

So most importantly, what CapitalSource does, I think, is really compete in the more creative sectors of the market, where being a true portfolio lender is of great importance, and that's obvious when you look at the products that we really traffic in, which is stretched (ph) senior loans, short term bridge loans and on a select basis, mezzanine financing.

And just -- and those loans themselves really tend to be involved in transactions which coincidentally are generally in transactions that are $40 million or less. Which is really a much less liquid portion of the market. That's not a portion of the market that large, large financial players engage in as actively as we do. We engage that market by offering today really 10 defined products. We have a very compelling product mix which provides us with significant bandwidth to address this very large market and in fact, this year, as last year, CapitalSource is on pace to exceed our origination expectations in real estate as a result of this broad product mix, national originations team, which we've doubled in the last 12 months and continued to grow in our established franchise and as a result we're very confident in our ability to continue to grow this business in an intelligent and meaningful way over the coming years.

I'll turn, for a minute, to our second significant business within structured finance which is lender and rediscount finance. There our clients are generally speaking specialty lenders. The majority of those clients and a majority of our activities in this sector are actually related to real estate because we transact a lot of business with mortgage companies as well as other consumer and commercial lenders.

This is an enormous market and it's a highly fragmented market. And perhaps in a way more so than many markets. There's a real need for highly specialized, highly customized solutions within this market and that's something which we've developed and delivered to the market over the past five years. We've done that by providing senior asset-based revolvers, we also have a very strong practice providing mortgage loan hypothecation as well as mortgage loan acquisitions.

And to deliver these, just in our core real estate practice, we've developed very specialized credit skills and we've developed a proven regime which involves intense collateral analysis, rigorous structuring and a true understanding of our borrowers, leverage off not only the skills within the business group itself but also from Capital Analytics and all the things that you heard Bryan Corsini speak about.

And that truly sets us apart from our competition. The competition again, if I broke it down into commodity and non-commodity, commodity lenders would be regional banks, investment banks, and certain securitization shops on the commodity side but where we really compete is against finance companies and not surprisingly, recently hedge funds have entered the market as well, although just as in our core real estate business, I think the fact that we have been in the market, been in the business consistently for five years and have developed all the processes and the credit that we have is a significant benefit to us.

So, to be successful in this highly fragmented market, I think there's really two things in rediscount that are of critical importance. One is really a very organized business development process. Second is servicing capabilities. The first is fairly obvious. The market is incredibly large, there is thousands and thousands and thousands of small finance companies, but to find the right ones is finding a needle in the haystack. We are able to do that because we have here as well developed a national business origination capability in our staff, and secondly, this business in particular really benefits from the breadth of capital source overall. This is a business where there is a lot of internal referrals from Joe Kenary's business, from Dean Graham's business and so there is a real engine here that's very synergistic with the rest of the firm.

Secondly, servicing, which I mentioned, is incredibly important because here our clients' back offices are really tethered to our back office for a number of reasons, some of which are credit-driven, as you heard Bryan Corsini discuss. We hold all the collateral, we control all the cash from these clients, and secondly they also need funding, generally one to three times a week.

So there is a real advantage in having this servicing capability, not only to protect our balance sheet and protect our investments but also to service these clients in an appropriate way.

CapitalSource is clearly a dominant player in this market by any measure whatsoever and we offer within the market a pretty compelling product mix. It is 100% senior business today. We - the basic offering that we have is really an on balance sheet revolving warehouse facility to these clients.

We also do purchase facilities on select bases and occasionally engage in whole loan purchase activities, so CapitalSource, within the rediscount market, is clearly a leader.

This next slide graphically depicts the diversification of our business today. We've broken it into really two charts, real estate and rediscount here. And on an overall basis, you may remember from an early slide, our average loan is about $8.1 million, so there is great granularity within this portfolio on an overall basis and you can see within each of these charts, significant diversification by either property type or product type but I think one of the things that speaks most loudly in this slide here is the fact that portfolio-wide our loan-to-value is literally sitting at 74%, which speaks very loudly to the senior orientation of this business.

And finally, I used this slide last year to just kind of sum up industry dynamics and what I would say is in the lender rediscount finance market, the market in terms of liquidity and competition has remained pretty consistent with where we were about a year ago. And looking forward over the next 12 months, we don't anticipate any significant shift in any of these various dynamics that I've indicated here.

On the real estate side I would say the same thing. There has been certainly more liquidity in the market lately but I think that's a force that's been in play for quite some time now. But it's such a large market that in aggregate it's not really changed our business or are approach to the markets.

So to sum up, we're confident in our ability to continue to grow this business in an intelligent and very meaningful way. I think we are very well-positioned lender with a scaleable business. We have had very strong and unparalleled resources and devoted energy, effort and capital to build a significant platform which separates us from the competition.

So with that I think we're going to take questions.

I think - are the mikes on? Yeah.

Unidentified Company Representative

Josh?

Unidentified Audience Member

Just a couple clarification questions. One, on healthcare can you give just some examples of what business credit services loans are and when you talked about the Mariner transaction, I didn't hear whether that loan was syndicated, so maybe you can touch on that and then on structured finance, what's the current split between real estate and lender rediscount loans?

Michael Szwajkowski - *CapitalSource - President, Structured Finance Group*

I don't have the exact number at my fingertips but it's about 60/40 real estate to rediscount.

Dean Graham - *CapitalSource - President, HealthCare and Specialty Finance*

I think you asked two questions, one about the Mariner transaction and how different (ph) and one about credit services. I'll take the healthcare question first.

The Mariner transaction that we participated in was one of the larger transactions in the country. We had teamed up with a partner that we do a lot of healthcare lending with which is Credit Suisse-First Boston and we participated in part of that loan. We did primarily, in fact exclusively a receivable part of that loan and that - we did not syndicate that particular piece and that piece - the reason why we didn't was we, for a variety of reasons which I won't go into here, that piece was substantially paid down so that - I hope that's responsive to your first question.

Your second questions is business credit services. Business credit services really spans the gamut. They lend to all sorts of small middle market service companies throughout the country. They don't - I think at this point I wouldn't say there is a particular - it's a very diverse group of businesses. Outsource businesses, consumer-driven businesses. There's no particular type of business that would dominate the sector but it's all - it's primarily asset-based and by asset-based I mean receivables and inventory.

Unidentified Company Representative

I was hoping you could - or maybe all of you could put a little more color on your private equity joint venture, size, how you're going to - what you're looking for in terms of returns you're generating and who the partners are.

Joe Kenary - *CapitalSource - President, Corporate Finance*

Well, I think the size remains to be seen. Initially it's a relatively modest equity commitment on the part of CapitalSource. The goal is to basically create a working model where we levered the CapitalSource origination engine in conjunction with a group of investors, a group called Portfolio Logic, which are primarily public equity investors but they have deep expertise in terms of equity investing and their backgrounds come out of various consulting firms. One of the principals is the partner based (inaudible) private equity diligence just on the consulting side.

And in working with them I think that that marries up quite well - within corporate finance we feel a lot of non-sponsored situations. Things where we clearly are not in competition with our customers. And I want to be really clear about that, but they are equity opportunities that we think are interesting but we're not really capable of taking advantage within the corporate finance group. It would be a distracting given the time necessary to governance (ph), all the issues that we found.

So what we want to do is create this joint venture, have a working model and actually go out and raise third party capital on the strength of what we think, which is the levered - we have the combination of the strong origination network and also a very strong investment expertise to then fill out a nice third party - so it's a relatively modest commitment on the part of CapitalSource in terms of the amount of capital.

I mean, it's about $10 million.

Michael Szwajkowski - *CapitalSource - President, Structured Finance Group*

Right. We're really effectively referring to deals in the loan - effectively capital management company and they'll manage the investments process and that'll be third party capital.

Unidentified Audience Member

Thank you. Dean, on the hospital deals, you mentioned you had done over the last year nine $200 million plus deals. I just wondered how much of those do you hold and what types of ...

Unidentified Company Representative

In the aggregate 200 million, not each one.

Unidentified Audience Member

OK. All right. That's.

Dean Graham - *CapitalSource - President, HealthCare and Specialty Finance*

Let me give an example. I think the slide says it - I think it was 13 transactions totaling in the aggregate $200 million so that really was an example to give you a little more texture on what was behind those numbers.

There was one of the largest hospital providers in the United States was essentially disaggregating a number of facilities, particularly on the West Coast and CapitalSource actually warrant all of the initial transactions and what I mean by that specifically is we were approached by other private equity funds in other hospital systems who wanted to by one or two or three of these facilities as they were disaggregating so, again, that was just to give you a flavor, it was 13 transactions and it totaled $200 million in commitments but it was a fairly diverse group.

Unidentified Audience Member

OK. What kind of hold size are you limiting yourself to in the larger deals?

Dean Graham - *CapitalSource - President, HealthCare and Specialty Finance*

The larger hospital deals?

Unidentified Audience Member

Yes.

Dean Graham - *CapitalSource - President, HealthCare and Specialty Finance*

The larger hospital deals we have maintained a fairly strict discipline with respect to that, I think. We have really not gone over $30 or $40 million in general hospital context and none of those deals - all of those deals I just mentioned are within that pen (ph).

John Delaney - *CapitalSource - Chairman and CEO*

The whole size calculations for the company, just a general kind of response to that question, varies base on a couple of factors, the underlying risk of the transaction and the nature of the transaction and those are different.

In the underlying risk of the transaction, the lowest hold size is in Joe's business because cash flow loans have greater risk, followed by real estate, followed by classic asset-based lending. We'll hold a substantial piece of an accounts receivable loan, as we view it as a very low risk profile situation.

So that's the first thing that goes into hold size determination and the second thing is it a pull transaction or is it a single operator and what I mean by that is in our healthcare real estate business, we'll have some larger holds, $50, $60 million but it will be a portfolio of nursing homes, so we may have 12 first mortgages on 12 different properties located in three different states.

And so we'll look at that and we'll say, well that clearly merits a bigger hold because you - first of all, the profiles good, it's a first mortgage credit, secondly it's pulled so you don't have single facility risk and your all cross collateralized. In fact, a little securitization.

There's a bunch of little pockets of our company where we do those kind of things, like in Mike's business, for example, he will - in the rediscount business we finance real estate lenders. Some of them are hard money lenders. We'll have a good sized hold with some of these people because really we're lending on their 10 or 15 loans which we pre-approved and it's all crossed. So we're almost creating small securitizations that we hold the whole thing and manage it for some of these underlying customers, either in the real estate business or the rediscount business.

On the real estate side it can be in Joe's business - I mean in Dean's business on the healthcare side or Mike's business on the structured side.

So we'll go up in a larger hold for something like that because clearly that's got a much different risk profile because the diversification of the credits and things like that.

Unidentified Audience Member

Thank you.

John Delaney - *CapitalSource - Chairman and CEO*

I think Don's next.

Unidentified Audience Member

How significant do you expect the net lease business to be and is that a business that you have the expertise in-house or is that a business that you needed to go out and find some people that have experience originating that kind of product?

John Delaney - *CapitalSource - Chairman and CEO*

I think that's for you.

Dean Graham - *CapitalSource - President, HealthCare and Specialty Finance*

The sale leaseback business? We think - we're very excited about the sale. Leaseback is general particularly on the healthcare side. We have a number of our borrowers who we financed both at CapitalSource and John's previous company have sale leaseback needs which we really haven't focused on while we're at CapitalSource, so we think we have kind of a very broad base of origination, if you will, that's in-house almost. In addition to that we think the way we track it so broadly through the healthcare community we have identified a number of opportunities consistently where we - if we had that product we could

- I mean, to be very responsible to your question, we think it's a very large opportunity for us and under our new election we think it can be a really exciting new product and further establish CapitalSource in a few areas - very few areas of the healthcare business which we're not already best in class.

John Delaney - *CapitalSource - Chairman and CEO*

There's probably about - I don't know the exact number, maybe somewhere between nine and 10 healthcare REITs that just focus on healthcare sale leasebacks and these things have anywhere from a billion to $2.5 to 3 billion of assets each and I don't think there's any question that in few years our team will be above average in terms, substantially, the size of our presence in that business and it's a great business for us because we know the underlying borrowing very well and it's got a very nice return profile.

I mean, the healthcare REITs, as a group, actually trade to a fairly tight dividend, somewhere between five and six percent, reflecting the predictability of the business and some of the core growth you get in those assets as REITs. So we think we'll build a healthcare REIT business right within Dean's healthcare business.

Unidentified Audience Member

Two somewhat unrelated questions. The one business I didn't hear you talk about much is factoring and I was wondering is there sort of a place for that in your mix and then also, I was wondering, Mike, if you could give us more kind of color in the companies and loans you're making in the rediscount business.

Michael Szwajkowski - *CapitalSource - President, Structured Finance Group*

Sure. The rediscount business, I had one slide that kind of broke the portfolio into four different general categories. So there's direct loan, auto, resort finance and mortgage. Mortgage is really - we'll start there. Mortgage is consumer and commercial - companies that are engaged in originating consumer or residential rather and commercial mortgage loans. Some of those - so that business - all those are in that slice of the pie and they're generally our borrower is originating a first mortgage loans which we just hypothecate.

In the resort finance slice here, we do a couple of different things. There's some timeshare lending in there where we really do two different things. We do basically an inventory loan which is a mortgage, that's just industry parlance there. So we'll have that part of this slice. We also do the accounts receivable financing for the timeshare business as well when a developer sells and interval and finances it and we'll take a pledge of those receivables and hypothecate them as well.

And then there's actually - within this slice more mortgage business related around kind of the fractional industry which is kind of the newer piece of the timeshare business, more upscale, where we're really just a first mortgage lender to those types of companies.

The auto slice is fairly self explanatory. It's really kind of scratch and bend (ph) B, C kind of credit. Not a lot of D stuff, it's more B, C kind of credits and we do that on an indirect and a captive basis and then the direct loans are really - that's kind of the most diverse slice of the pie, here, because that's anything from a payday loan to - we had one company that made loans secured by freezers with neat (ph) in them which - So it's pretty hard to go through all those, but it's very broad and really - and that is actually the more - in that there is a little more sub prime kind of stuff. Very high yielding paper.

John Delaney - *CapitalSource - Chairman and CEO*

And then you have the factoring question. We don't really do any factoring. We do finance some factoring companies. Dean - his business finances a healthcare factoring company on a rediscount basis. But as an industry and as a kind of line of business it's been our view that it doesn't fit particularly well within our profile of the kind of customers we finance.

We're actually - even though we're middle market and we do a lot high test (ph) we're a little more up market than a factoring customer. It's somewhat a shrinking business. The only growth in factoring that I think is occurring is on the technology side with some interesting platforms, but classic factoring business is shrinking and it's just a particularly attractive business to our minds.

I think next was up there.

Unidentified Audience Member

Hi. I was just curious if you could talk about some of your operating metrics by business. I think historically you've talked directionally about your yields, operating expenses, loss ratios were by business segment but could you put some numbers behind those perhaps, saying what they've been over the last six months or so.

John Delaney - *CapitalSource - Chairman and CEO*

We don't report different business segments from a finance and accounting perspective so we don't break it out by line of business which is to some extent related to the way we treat the portfolio from an accounting perspective. We don't do segment reporting by line of business and I think Tom, I don't know what you'd add to that.

Man in the back?

Tom Fink - *CapitalSource - CFO*

I would say that qualitatively speaking, at least historically how we've looked at the business is they all, I think had been gotten to roughly at the same bottom liners at the end of the day. Obviously in Dean's business you do a lot of smaller loans, a lot of high touch loans, which a very heavy day to day intensive services platform so there's a lot of costs associated with that, but he's got a lot of yields and relatively small credit provision, for example because it's mostly asset based lending that he's doing there.

And the other businesses have different mixes but I don't think that the bottom line result is terribly different across the three of them.

Unidentified Audience Member

(inaudible - microphone inaccessible)

John Delaney - *CapitalSource - Chairman and CEO*

All the reasons you'd expect. Performance measurements. Trying to assess which lines of business are good and not good, profitability by line of business - we break it all down at kind of the sub business level but I'm really responding from a reporting perspective. We've made the decision to be treated as one commercial finance company, not have segment reporting, so as a result of that we don't disclose any segment level detail for fear of the slippery slope.

Unidentified Audience Member

Two questions for Joe. Joe, you mentioned Europe in your asset management business and I was curious what you're doing there and then two, it's pretty obvious how the REIT election helps Dean's business and being able to do sale leasebacks. How does the REIT election affect your business in any way? Are there certain aspects of things that you've passed on historically that you can now do that become more appealing, certain slices of a transaction that you probably might have an opportunity that you didn't have historically where KKR Financial raises money as a REIT and they're doing certain slices of stuff that you couldn't do but now you can do.

So Europe and what does the REIT election mean to your business.

Joe Kenary - *CapitalSource - President, Corporate Finance*

Sure. I'll start with the Europe answer. Over the last few years we've executed a few transactions in Europe and I think in doing so we've started to look at what sort of opportunities there would be for a smart, flexible creative lender and to base (ph) we've delivered our product in Europe and I think we've invested a fair amount of time over the past year determining if there is a market opportunity, but then how to go about executing on that market opportunity, doing a lot of non-balance sheet or an off-balance sheet entity, I think we've come to the conclusion that the best way to get the scale with a reasonable - to build a business that basically matters, I think we viewed it as better to have an off balance sheet entity so our goal is to basically put together a first class team of - bring over some of the CapitalSource DNA then the dealer a team of first class origination professionals really oversees and we've actually hired already one person over there - hired two people, I'm sorry, and I'm talking to several others so we think that we're really in the process of doing that and once we get that team a little more flexed out we then think we go out and raise third party capital and then really leverage the CapitalSource franchise to do that and build what we think is a very powerful pan-European lending opportunity. We think that is a pretty significant market that a smarter lender can build on.

The answer to your question about the REIT election, first of all I think just - I think the opportunity is a great one. I was involved in the process and as we thought about how it affected corporate finance, I think you can cut it one of two ways or both ways, actually. I think the important thing is that fundamentally all the things I talked about in my business this doesn't affect. There's no governor on what we're doing. We can continue to build our business and attack the opportunities as we see them.

More importantly, what are the different products, more directly, I should say, to your question. I think we think that the biggest probably and most obvious answer is that sometimes in transactions there is a significant real estate component and if we can provide a competitive and attractive cost to capital, in the form of like a sale leaseback. We think that's a very effective way. Or some sort of mortgage facility.

That's a better way to be competitive and what is obviously a pretty competitive market. So that's probably the most direct answer I could give you but more importantly I think we within corporate finance I think are excited to be part of a larger whole that I think recognizes the power of the earning model in CapitalSource.

John Delaney - *CapitalSource - Chairman and CEO*

Another question - I thought I saw a hand there.

I was going to suggest we have a break now but perhaps it might make sense to just push through with the next part of our presentation. Because it's about 4:00. Tom, if you wouldn't mind?

Tom Fink - *CapitalSource - CFO*

(inaudible - microphone unavailable) Financial Officer for CapitalSource, and I'm going to talk to you this afternoon about a couple of things. First, I want to review our financial performance since our IPO, which has been terrific and has really exceeded all of our initial estimates for the business, and we're really quite proud of the financial performance of the company.

I also want to talk about our funding sources and liquidity and give you an update on the tremendous progress we've continued to make on that front in the business, talk about capital planning and our considerations about funding the business going forward, touch on leverage briefly and then interest rate sensitivity before turning it back to John for a wrap up.

One the highlights of our company since going public has really been the asset growth in the business, and as you can see from this slide, which I made the numbers even bigger than Jason's version of the slide is to show you how dramatic it's been. The first quarter as a public company back in the third quarter of 2003, we had just under $2 billion of assets at the end of that quarter, and the number at the end of August was 5.2 billion, and it's over $5.3 billion today. That translates to about a 68% compounded annual growth rate of the business, and really truly one of the strengths of CapitalSource is our origination teams. The lending businesses, you just listened to three presidents talk about them, but what I can tell you is that they have always exceeded and surpassed our expectations with respect to growth in the business, and it's really been quite impressive.

When you look at the performance by quarter, I mean, the prior slide shows you a continually steadily increasing balance, and it certainly goes up every quarter, but when you peel it back a little bit and look at the net portfolio growth quarter over quarter, you see something that's a little bit more lumpy, but I would say still consistently high. And I made the point before that our teams have always surpassed our expectations with respect to growth, and you really see it on this slide. When we went public back in 2003, our initial growth forecast of the company, net growth, was about $1 billion a year, and that's a $250 million a quarter pace, roughly speaking. And you can see that we really only operated at that level one time, which was the first quarter as a public company, $246 million. And, since then, we've exceeded that level and have really never looked back.

And if you average all these other quarters that are here, excluding that first one, it's over a $440 average quarterly growth level. So we can sit here in front of you and talk about our growth, but we feel very confident in our ability to continue growing the business as we've laid it out.

This portfolio growth since the IPO, the strong yields, the net interest margin that we've seen in the business, consistently, and really growing into our leverage for the business, the targeted leverage we had for the business, has delivered the strong and growing returns for our shareholders that we thought we would. The chart on the bottom, our pretax ROE, you can see that for the last four quarters we've exceeded a 25% pretax ROE, and in the last quarter we were posted 30% pretax ROE. So very, very strong returns financially in the business.

And this translates, obviously, to very strong earnings per share, which as I mentioned have really surpassed all of our initial estimates for the business. The earnings per share growth in the company, since becoming a public company, has been about 42% compound annual growth rate. CapitalSource is fortunate to have many analysts covering the company and following our progress and that coverage universe has expanded this year, and we're pleased about that. And as the analysts have followed the progress of the company, they've generally increased their earnings estimates over time for the business, and I'm very pleased to say that in addition to surpassing our own expectations for the business, we've met or exceeded the analysts' final consensus for earnings every quarter since being a public company.

Talk about funding and sources of liquidity for a minute. You can see from the pie chart on the left that a significant portion of our funding comes from the term debt market. These are the term debt securitizations we do, typically two times a year, about 47% of our funding coming from that marketplace at June 30th. We've done over seven transactions and raised over $4.2 billion in that marketplace, and we think it's a very deep and liquid source of capital for us. We also have significant warehouse credit facility capacity. We currently have six general or main credit facilities with 11 different banks and $2.5 billion of credit facility capacity.

And we use those credit facilities to warehouse loans, typically before doing a term debt securitization, so the mix between term debt and credit facility moves around a little bit, but both significant sources of funding. But we also have some unsecured funding on the balance sheet, which is the convertible debentures you see, and then of course a very strong equity capital base, exceeding $1 billion of tangible book equity. And I think we have demonstrated consistently over the years our very strong, good access to the capital market.

I mentioned we have had a lot of achievements in this area. In the last 24 months, last two years, we've made improvements in every aspect of our funding program. We have improved our credit facilities by increasing the number of facilities we have, broadening our banking relationships, improving the terms and flexibility for CapitalSource, lowering the cost. We've built upon our success in the term debt securitization by increasing the size of the transactions. Our last deal, which was completed in April of this year, was $1.25 billion in size. And each one of the executions there has gotten better and better.

The efficiencies of the structures have improved and our transaction costs have been coming down as we've done more and more transactions. And we've made a good start, I think, on our unsecured funding program. Last year, we did two series of convertible debt to kind of get started on that front, or attain an initial investment grade rating from Fitch. And we look forward to expanding our unsecured funding going forward.

To give you flavor for just a couple of the things we've done on the credit facility side, our main credit facility for example this year, we increased the size of it to $826 million from 700 million. We added Bank of America s a participant. We put a new facility in place with J.P. Morgan, which we're excited about, because among other things it brings some important and valuable flexibility to us. Joe mentioned Europe, for example. We have the ability in this facility to fund loans in foreign currencies, for example, if that was something that the company wants to do. So we're pleased about that, and you can see the chart at the bottom how we've consistently expanded the capacity while at the same time reducing the cost of those facilities.

The term debt market, this slide kind of gives you a good snapshot of our progress there. It's a very deep and liquid market for us. At the top left, you can see how the transactions have increased in size. On the top right, you can see how the advance rate in each of those transactions as increased also. But best of all on the lower right-hand corner is the pricing, and you can see how that's really come down as CapitalSource has really become one of the premier issuers in the middle market space, and we've got a terrific franchise and presence in that market. Looking forward, we have some other ideas to continue our progress here. We of course want to continue widening our investment base, but there's a few features that we think we can add to these transactions that will make them even more efficient for us and help lower the cost of funds even further.

For example, we've talked about prepayments and how that affects the portfolio, but it also affects our financing costs, because these transactions were all done as static pool deals, and when a loan prepays in a deal we prepay the debt as well, and that causes the life of the debt to be shorter, and therefore it causes us to amortize the financing costs over a shorter period of time. We think if we add a reinvestment feature to the transaction, we'll be able to reinvest proceeds instead of paying off the liabilities, and that will allow them to last longer and therefore reduce our funding costs over time.

Now, unfortunately, if you just read the financial statements, you can't see a lot of the progress we've made, because the blue line, which is our cost of funds, has been going up, but that is entirely driven by the red line, which is average one-month LIBOR. We're a floating rate borrower, floating rate lender, generally, so rising short-term rates, which we've seen over the last six to nine months, has increased our cost of funds. So let me help you out and show you what the borrowing spread is, and this really shows the progress we've made.

In the last two years, we've reduced our funding costs by about 100 basis points on a borrowing spread basis, at the same time adding about $3 billion worth of debt to the balance sheet. So, to put that in perspective, we've cut our borrowing spread basically in half while more than tripling the amount of debt on the balance sheet, so I think that's a very, very good track record. So, what can we do to top that? Plenty, I think, actually.

Our future capital plans generally an be summed up by saying we're going to do more of the same and then we're going to do a lot of new things, too. We're going to continue our securitizations for our asset-based and our cash flow loans. I think doing securitizations periodically is a good thing, because it demonstrates the marketability of our assets. And as I mentioned, we're considering some enhancements to those transactions that will further improve our efficiency and funding costs in the future.

But a main objective for us is also to increase our unsecured funding base. We're going to started actually next week on an unsecured bank facility. We have many of our lenders in the audience today and we've been talking to them a while about that will be our next step in the unsecured bank - excuse me, in the unsecured funding strategy. Then we also over time pursue some term unsecured issuance as well.

CapitalSource Bank, John mentioned this in his remarks, we're very excited about the bank. Again, this is a Utah industrial bank, and it's for us a form of deposit-based funding. The industrial banks raise capital, raise liabilities through the broker-deposit network, so many of you might have accounts where you've got a CD, for example. CapitalSource Bank will be in that marketplace. We think it's a very deep market for us, and a very attractively priced market as well. Those deposits are fixed-rate deposits, so actually it will give us the ability to make some fixed-rate loans, naturally, which will be good, but we can also swap in the floating. Floating rate basis, the funding costs there are generally very close to LIBOR flat, or LIBOR plus 10 basis points, so that would be a great benefit for us.

We're in the process of forming the bank. We've submitted our application. It's been accepted as substantially complete by the FDIC and they're working through their process, the state of Utah is working through their process and we're hopeful of having the bank online as soon as the end of the year. And, of course, we'll develop additional financings that are appropriate for each of the new products. Some of the things that we've looked at involved government-guaranteed loans, for example, that obviously narrowed to a different and better financing than we used to finance our loans, so we look forward to that.

And, of course, we'll increase our equity capital markets activity. Jason talked about our plans to raise equity before the end of the year. CapitalSource did not raise any primary equity since the IPO, really, in 2003, so we'd like to raise some capital for the business going forward, and then of course the REIT election will increase our activity in that marketplace.

This leads me to talk about leverage. I'll talk about this just briefly. The main point I want to make is there's not one single number that's always right for a company over time and in a lot of market conditions. There's many things you need to consider when you're thinking about the proper level of leverage, things about the assets, what the return profile is, credit profile of the assets, what's your business? CapitalSource has been able to produce a very stable return on assets, which gives you confidence when considering your assets, but also we've got a growing, diverse and very granular portfolio, so having that mix of business is helpful.

But, most importantly, to me, are the funding and liquidity considerations, and our desire here is to maintain a very strong balance sheet, particularly because we know we're dependent upon the capital markets in our business. So we never want to max out the leverage that we can achieve. And we also think it's important, when you think about leverage for the company, consider the types of assets and really the mix of assets we have.

So, on this slide, I wanted just to review what our general view is of the appropriate level of leverage for CapitalSource today for the different types of assets. And here we've got our core products laid out, our senior secured cash flow loans, asset-based loans, first mortgage real estate loans. We do some mezzanine loans, or some subordinated lending, not very much, but there's some of that. And, consistent with my point that we never want to max out leverage, you can see our view on the right. I won't read all these numbers, what the appropriate level of leverage is for each of these products, and these are more of internal guidelines that we use in the business, but they are comfortably within the levels, the advance rates, if you will, that we can achieve on our credit facilities, and I will also point out that they're far below the level that we can achieve in our term debt securitizations. When we do a term debt securitization, we can get up to nine times the leverage in those vehicles.

Overall, and those are all on-balance-sheet transactions, CapitalSource is committed to maintaining an I think very modest and moderate level of leverage in the business. And these numbers here, if you were to lay out our balance sheet and do the math, you'd come up with a four to five times range for the business, and we're very comfortable with that level.

The last thing I want to talk about is interest rate risk, and I won't dwell on this. It is not a big issue for us at all. We're generally a floating rate lender, floating rate borrower. Most of our loans are based on prime or LIBOR, most of our liabilities are based on LIBOR or CP, which is very close to LIBOR. We do, however, have some interest rate floors, which are very helpful. If you got into a significant down interest rate scenario, I don't think anyone's really expecting that right now.

So CapitalSource today is sitting here in a slightly asset-sensitive position, so that as rates go up, that will be a benefit to us. We do model rates going up. We simply use the forward curve for LIBOR in terms of modeling our future expectations for interest rates. And this next slide, which is the static pool analysis that you typically see people do, banks do, finance companies do, what happens to your portfolio if rates move up or move down, and this really supports what I said. We're in a slightly asset-sensitive position, so if rates go up, we'll make more money. And then if rates go down significantly, we have the benefit of the interest rate floors on our loans that will offset some of that.

And this is our view of interest rates. It's a couple of days old, so we don't have yesterday's Fed increase in here, but it is part of the dashed line that was expected. And you can see that from really 2006 we're looking for a relatively flat or constant short-term interest rate market for LIBOR, generally about 410 basis points, 4.1%, so when you look at our guidance for 2006 of a 4.8% cost of funds, it's versus a 4.1%, roughly speaking, average LIBOR rate.

And, with that, I think we're done. One point I wanted to make just as a matter of clarification. We had some discussion about charge-offs and non-accruals. I just wanted to reiterate that our charge-off assumption for 2006 is $42 million. I think there was a question by somebody for that, and that this compares to 117 million of loans that are now on non-accrual as of August 31st.

QUESTIONS AND ANSWERS

John Delaney - *CapitalSource - Chairman and CEO*

Questions for Tom?

Bob?

Bob Napoli - *Piper Jaffray - Analyst*

Two questions. One, you had talked about giving earnings guidance I think earlier, more specifically, and I just wondered what your thoughts were on that. Do you plan to give more specific EPS, GAAP and tax EPS earnings guidance for 2006 and, if so, when?

Tom Fink - *CapitalSource - CFO*

Yes, I think we will. I think the most important thing for us in making the REIT election was to get people immediately in the zone of what the dividends are. We understand that that's an important metric for investors and we wanted to get that number out right away. As we've talked about today in this forum and even on our call on Monday, there are some book tax differences that affect all that. There's a different - our diluted EPS, the share count is not the same as the shares that you pay dividends on, so I think we will be more specific about those two things, and, also, as I mentioned, we're considering developing an adjusted EPS number, if you will, to help get people get comfortable. Or help people better understand what the dividend payout will be relative to the earnings of the company, to try to bridge some of those differences.

Bob Napoli - *Piper Jaffray - Analyst*

Okay, and second thing is just on funding. The bank, first of all, maybe, if you could give me some feel for how large you think the bank funding could be, what the mix of the CapitalSource funding - do you have that built in, and what would be the cost of that relative to your current cost of funds?

Tom Fink - *CapitalSource - CFO*

Well, the bank, our current thinking now is that the bank will be part of the taxable REIT subsidiary and we'll use that to fund a good portion of our corporate finance and asset-based lending that gets done out of the taxable REIT subsidiary. Is there potential that the bank could finance the REIT in making its real estate loans, but there are some issues that we'll need to work through there to see if we're able to do that or not, but what we're looking at right now is the bank being part of the TRS, funding a portion of the corporate finance and asset-based loans.

The funding costs, as I mentioned, if you were to think of them on a floating rate equivalent, it moves around as a retail-oriented funding base. The numbers move every week, but if you swapped it back to floating rate, it's been LIBOR flat, LIBOR plus 10 basis points, anywhere from six months out to three years in duration. So it's I think for us a relatively inexpensive source of funding.

Bob Napoli - *Piper Jaffray - Analyst*

Thanks.

Unidentified Audience Member

Do you have a sense for how much unsecured debt you may layer in in '06 and '07? And then I think someone alluded to guidance would be coming out soon, with next quarter earnings, or what does soon mean?

Tom Fink - *CapitalSource - CFO*

Which guidance are you referring to, Joel?

Unidentified Audience Member

EPS.

Tom Fink - *CapitalSource - CFO*

I think unless we have something more to report, our next update will probably be on the earnings call for the third quarter results, which will be at the end of October.

John Delaney - *CapitalSource - Chairman and CEO*

That's a good time to go through all of this. We'll have everyone's attention.

Tom Fink - *CapitalSource - CFO*

And in terms of how much unsecured funding, I mean, we haven't sorted through that completely, but it's clearly more than we have now, and we'll see how quickly the bank comes online and what that is. I mean, I think that can be counted in terms of when I think about unsecured funding, that's a good part of it, the deposit-based funding as a subset. We're currently more heavily weighted towards secured funding, and I'd like over time to have us have more balance between the two.

Unidentified Audience Member

Since this company came public, it's always been a growth company. Given the change in the corporate structure, has your propensity or desire to grow and be a growth company changed, and once we get beyond this kind of transitional dividend period of '06, '07, can we talk at all about what kind of growth rate would make sense. And does the new structure in any way limit that growth?

Tom Fink - *CapitalSource - CFO*

As I said, the new structure does not limit that growth at all. I think that's one of our points here, that we can continue growing all of our businesses with our core products, our legacy products as well, in addition to having new opportunities, new products. So I would we still are very much a growth company. We see significant growth in the dividend that we're projecting for '07 versus '06. Part of that is due to this point we've made already about making greater use of the efficiency of the REIT, but a lot of it is also just growth. So I don't see this affecting our growth rate at all.

In the past, we've talked about the 5 billion to 15 billion as being our next midpoint, and we'll certainly get to the 15 billion I think a little bit faster now.

John Delaney - *CapitalSource - Chairman and CEO*

This election is really all about growth I think, actually, at the end of the day. The growth in the earnings, we've always advised that the growth in the earnings in this company would slow off the rate that it was when we went public, because once we approached our leverage targets, the growth would more approximate the ROE of the business. And if you look at what our earnings per share were at the time we went public compared to the dividend projection for 2007, this continues to be an incredibly steep growth rate on a per-share basis, out to 2007, which is 2.5 years from now, which is longer than we've even been public.

So the growth from an investor's perspective we think will continue to be high. Thinking about the enterprise, not necessarily just investors, but the enterprise, I think what's most exciting about this is it does give us an opportunity to grow this business larger, and we generally think growth is good. It excites people, it makes them want to get up in the morning and go to work. There's new things for them to do, and this is an incredibly exciting development for the company. So I think this thing is in some ways all about growth, both from an investor's perspective and from a cultural perspective in a company.

Unidentified Audience Member

Does the new structure trigger any changes within your existing convertibles in terms of strike?

Tom Fink - *CapitalSource - CFO*

Well, there's provisions in the convertibles that would adjust the conversion prices as we pay dividends, so I think that's pretty straightforward, but there's nothing else that we see that happens.

Unidentified Audience Member

And do you anticipate that your spreads would widen as you change structures and you stop retaining earnings and you're more dependent on raising outside capital, it gets better ...

Tom Fink - *CapitalSource - CFO*

Our borrowing spread?

Unidentified Audience Member

Yes.

Tom Fink - *CapitalSource - CFO*

No, I don't think they will. I think, you take each one of those components and we certainly don't anticipate our warehouse lending spreads going up. We certainly expect to see continued progress on the secured debt side, perhaps not as dramatic as we've seen in the past, but generally low levels. I think unsecured debt is certainly more expensive than secured debt, but I think there's a tradeoff there in terms of the flexibility to the company. So implicit in our model is a continued narrowing of our borrowing spread, and our guidance is 4.8% cost of funds, and I just told you that our expectation for rates today is 4.1, so that will tell you we're going to get to 70. So we've got some work to do to get there, but I think we can do it.

Unidentified Audience Member

How much - some spreads have just tightened generally. When you do analysis relative to where spreads have just gone in general in the securitized market, where do you compare? I'm presuming you're better than what the market has done.

Tom Fink - *CapitalSource - CFO*

Yes, I think that's for sure. I didn't put the slide up. We had a slide on this last year, actually, and we talked about other types of asset-backed issuers, and there were credit cards and autos and things and the entire marketplace, the spreads have compressed. But if you look at CapitalSource relative to those, we have compressed a lot faster and a lot further. Part of it's because the market we're in, middle market lending, I mean, we're not the only people that issued securitizations for these types of assets, so they're better understood by the market. But more importantly, I think it's because CapitalSource, really as a brand, is recognized. I mean, we are the largest issuer in that market.

We've done seven deals and $4.2 billion, so people like our orientation in the market, that we're financing our balance sheet, so I hope that answers the question.

Unidentified Audience Member

And I guess the final question, it's probably more of a general one. It looks to me like your portfolio growth on an absolute basis, it generally speaking is decelerating from, like, second quarter '04 down, and it appears to be the case this quarter through 8/31. Is that just due to prepayments, or are there any trends in there?

Unidentified Company Representative

I'd say that's primarily due to prepayments. If you looked at that one slide that I showed, actually, commitments are up about 800 million year to year, so we're seeing plenty more activity. We're seeing a lot more deals, we're offering term sheets on many more deals. We're closing a few less than we have, although we've seen that activity pick up so far in the third quarter, and we just think it's a temporary dislocation in terms of those two downticks that you just referred to.

Unidentified Audience Member

Thank you.

Tom Fink - *CapitalSource - CFO*

There's a question over here on your right.

Unidentified Company Representative

This gentleman next to the ...

Unidentified Audience Member

It wasn't your slide, but I'm sure you could answer it. On the average loans for '06, the 7.2 billion, I think, some portion of those loans will be sort of marginally earnings positive. They'll be added because of the REIT election. What dollar amount?

Tom Fink - *CapitalSource - CFO*

Well, I think that guidance is 7.3 billion of average loans on our core products. So what you see, what people have talked about today.

Unidentified Audience Member

All right, and then also the timing to do a securitization that would allow for more of a revolving nature where you can top off and put more securities in as they're paid off, when do you think that happens?

Tom Fink - *CapitalSource - CFO*

I think we'll do another transaction before the end of the year. Part of the thing is, when we start the bank, for example, we would like the bank to start with a big portfolio, so it has some critical mass from day one, and that competes a little bit with our next securitization, so we've shown a track record where every deal is larger than the last. I don't think that our next securitization will be as big as our last. It might be half the size or less, so we're holding some other loans that will go into the bank when the bank starts.

Unidentified Audience Member

Kind of a general question, I think for John. How does the REIT election affect your hurdle rate on non-REIT eligible assets? There must be some optimization there, because I know you want to put the higher-return assets in the 25% bucket of the QRS, but

that would mean that if you did lower your return requirement on the non-REIT eligible assets that you're not getting the full optimization in the QRS. So did your rate hurdle rate of return on some products change on your non-REIT eligible originations?

John Delaney - *CapitalSource - Chairman and CEO*

No, we're not projecting any change. I mean, we look at them on an after-tax basis. So if we're in a business that fits into the qualified REIT subsidiary, we have a lower hurdle, effectively, because we don't have the tax rate to pay. If it's a business that goes into the taxable REIT subsidiary, which a lot of our corporate lending does. It will have to have a higher hurdle.

There's already been a spread within the current portfolio. If you take the various products that the company offers, there is a spread. All of these business groups have targets which reflects a blend, so they have some discretion to be tighter on certain credits and price more aggressively on other credits. So it's not changing the targeted returns for the non-real estate, if you will, businesses in the company.

Unidentified Audience Member

So, for example, if you looked at a transaction, you wouldn't necessarily say, well, I wouldn't do this - this isn't a TRS transaction because I don't like the after-tax return. This isn't a TRS non-REIT eligible asset because I don't like the after-tax return, but it could be a 25% bucket QRS transaction because the pretax is okay?

John Delaney - *CapitalSource - Chairman and CEO*

I don't think we'll be that precise. I tend to think what we'll do is things that we know that are in the 75% bucket of the qualified REIT subsidiary, so things that are squarely real estate in their orientation, I think that's where we'd have the opportunity to price tighter, because we know that those - we don't have to pay tax on those. I think the 25% is kind of an optimization, where we take this large pool of corporate assets and we cull the ones we put in there, making sure they fit, including accounting the value of the TRS. And so I don't think we'll be as precise at least in the near term in taking the corporate stuff and saying some of that can be tighter than others, because some of it can go over there.

I think we'll keep it in some ways more simplistic, which is if it's corporate asset, it's going to have to have a higher return than if it's an asset secured by real estate.

Tom Fink - *CapitalSource - CFO*

Yes, let me just add one thing to underscore that. I think, generally, the pricing in the business is driven by what's the appropriate pricing for the risk in that loan, and I don't think that just because, hey, we're making a REIT election, everybody, it's a 20% off sale, let's lower pricing across the board, it doesn't work that way. We will maintain our pricing discipline on those products. I think where you see potentially lower margins is on the margin, on the incremental, the new assets that are products that we wouldn't be interested in today as a C-corp we are interested in as a REIT, because there is a lower cost of capital.

We can make those loans profitably, and the pricing is prudent for those loans, because it's a different risk profile. It might be a safer loan, or other things.

Unidentified Audience Member

John, can you comment on how you balance the need to raise equity with the need to show growing dividend? So you put in $600 million of capital raised in '06 in order to get to the $2.70 or $2.67 adjusted for that in an '07 dividend. Let's say the world

stays bad and oil stays high and gas stays high and Rita was just upgraded to a category five, so who knows, and your stock's $18? Do you ...

John Delaney - *CapitalSource - Chairman and CEO*

What a depressing way to end the conference here.

Unidentified Audience Member

I'm not hoping ...

John Delaney - *CapitalSource - Chairman and CEO*

I'm only kidding. I'm only kidding.

Unidentified Audience Member

You need to - before I start drinking ...

John Delaney - *CapitalSource - Chairman and CEO*

Just giving you a hard time.

Unidentified Audience Member

Before I get my cocktails, let me get this out of me. I'm just curious, because you might say to yourself, I'm not going to raise $600 million at $18, and if I don't do that, then my dividend is $2.30 in '07, or some number, some number less than that, but I'm not going to raise equity at such and such a price. So there's a little bit of a circular argument that goes on when you become a REIT and you become - I don't want to use the word beholden - but slightly beholden to the equity markets as to when you can and if you can raise capital. So I'm just curious how you're going to play that scenario out over time as to will you be willing to lower my dividend in '08 or '09 or whenever it may be because I'm not going to raise capital at this price at this pint in time in order to meet a dividend I've told you I might give you. I'm just curious how you go through that circular.

John Delaney - *CapitalSource - Chairman and CEO*

Well, it's a balance, and it's really driven by the opportunities in the market, I think, because if there are very good lending opportunities, then you raise capital to fund the growth of the business. If the opportunities present themselves as good - if they're not, you don't raise capital, almost regardless of the price, I think. So I think it's a delicate balance. We want to raise capital at an attractive price for our existing shareholders, to fund the growth of the business, if the growth is attractive. And we've always maintained the view that if we have attractive growth opportunities, if there's good opportunities, we should be able to raise capital at the right price because the market will recognize that. And if for some reason the market is probably not pricing the equity appropriately, it's because they don't think the opportunities are that good to some extent.

So I don't know what you'd add to that.

Tom Fink - *CapitalSource - CFO*

The only thing, I was a little confused by part of your question, which his we are not going to be raising the equity to pay the dividend. The dividend will come out of cash earnings, which we think will be sufficient. But I just want to echo what John said, is basically the growth that we see in the equity is based on what our internal projections are for growth in our assets, so that we can maintain the leverage ratios that Tom showed on a slide earlier.

Unidentified Audience Member

So in theory - are you saying you could pay the '07 dividend even if you did not raise $600 million of equity capital in '06.

Tom Fink - *CapitalSource - CFO*

Yes, that's correct.

Unidentified Audience Member

But obviously that would affect your ability to pay an '08 dividend, because in theory you would need that capital in order to grow at some point - I see your point about it being circular. Well, at some point you need the capital to make earnings to grow assets and you can't keep paying an increased dividend if you can't grow assets, and there's a balance there of where you raise equity and where you don't raise equity because you could grow an increasing level of dividend.

Tom Fink - *CapitalSource - CFO*

You're right, it's totally a balance, but I think the main point for us is that we will raise equity when we see the growth opportunities. We have told you all we plan to raise equity this year, raise equity next year, because we see a lot of growth opportunities. If those growth opportunities weren't there, we wouldn't be raising the equity. If there are more growth opportunities in the future, we'll raise more equity and go through that balance that we will have to do.

Unidentified Audience Member

Last follow-up question on that. What do you think the dividend would grow at off of the '07 base? If we agree that the '06 dividend is not representative of the earnings power of the company because it doesn't reflect the optimization of the structure, so we all should kind of look at the '07 dividend as the starting point, what do you think the reasonable five-year growth rate off of that dividend is? Is it 5%, is it 10, is it 15?

John Delaney - *CapitalSource - Chairman and CEO*

It's probably - I mean, there's a few things going on that could change it. Most entities, once there's stabilization in this kind of structure, generally the dividend grows at 5 to 10%, at least that's what you're seeing at peer group that we put up on the slide, is a 5 to 10% growth in dividend year over year once they hit stabilization, which makes intuitive sense, assuming you're not leveraging more, which we probably wouldn't be planning on doing, or assuming you don't have any other margin expansion. Because once you hit your targeted leverage, that's really the only way to expand the growth above something like that.

There are some opportunities for margin expansion obviously if the business more efficient, and we've outlined some fee businesses that are being overlaid into the platform that could drive additional dividend growth in some of the out years. But I think that the one thing that we can say that we're very comfortable with respect to, because we haven't modeled the '08 dividend yet, I mean to be honest with you, is that the growth between '06 and '07 will be much higher than the growth between

'07 and '08. There's just no question about that, in large part, because of the efficiencies of the structure. But once the efficiencies of the structures are realized, then the growth in the dividend becomes more consistent with the peer group, absent margin expansion, which could occur through expense savings or through other fee business that are driving earnings without capital.

And we're trying to roll some of those things now. In Dean's business, he's made a lot of money servicing assets for other people. Joe's rolling out some asset management. We have a lot of fee businesses growing in the company that could drive dividend growth that is not capital dependent. I think we'll have a better sense as to how meaningful they'll be next year as they start unfolding, but those are the kinds of things I think we're going to increasingly try to do that could result in higher-than-average dividend growth.

Unidentified Audience Member

Looking at this from an ABS investor's perspective, I have a question about the quality of the assets, and it seems like the due diligence process that was described earlier was substantive and to my mind time consuming. I'm wondering if given the growth in the portfolio, if you have experienced any difficulties in doing the same amount of due diligence on these loans with the same or slightly additional group of people, and whether or not any of that is going to flow through to the quality of the assets down the line. And, also, if you can comment on what percentage of the loans are to repeat customers or to customers that you're already familiar with that you don't have to provide the same amount of up front due diligence on.

John Delaney - *CapitalSource - Chairman and CEO*

You're getting to scalability of the business, can we maintain the focus and the quality of work, and we believe we can, and we believe we have. It's part of our job. It's the execution part of the business, which is the hard part of businesses like this. These are all execution businesses at the end of the day, and we believe we've put in place a process and a management structure in place that will allow us to continue to scale it up, and we think we have. And we believe we can continue to do that and it's one of the main jobs that we have is to make sure that we continue to do that.

Is there another part?

Tom Fink - *CapitalSource - CFO*

Yes, the second part of the question, year to date, a third of our loans, dollar volume that we've closed, has come from either existing clients or existing sponsors, which are people who brought in other companies with the same underlying private equity firm. And we think that is going to grow. It's grown every year. I think as you look at scale, what's getting easier, with a built-out platform with 22 offices, with a name that's well recognized in the market, and I think that's really been one of the key aspects of why we've been able to continue to grow the amount of business we've seen and that we've presented on and frankly that we've closed in terms of commitments, is that we really are a much more known commodity, not just to our clients, but to the markets that we tread in at large. And I think that will continue.

Unidentified Audience Member

Going back to this sort of circular discussion about capital and dividends, we've seen other companies issue a lot of equity and produce not much in the way of growth. As you look past '07, is there sort of a philosophical mindset yet in place about earnings retention, equity issuance and growth and sort of an internal commitment to what you think you can accomplish?

John Delaney - *CapitalSource - Chairman and CEO*

I mean, there's a philosophical mindset, which is that we will raise capital if we have good opportunities, and we believe there are many good opportunities that are now available to this platform. I don't think we're at this point willing to be specific about what they could mean, but it's my sense that we will have good opportunities to continue to grow this business, and if we have those good opportunities, we will raise capital to fund them, because it will be in the interest of the shareholders to do that.

Unidentified Audience Member

Isn't there a point where maybe retention is a better issue?

John Delaney - *CapitalSource - Chairman and CEO*

Retention of capital. And we have the ability to do that.

Unidentified Audience Member

And you have the ability to pay out less than 100%.

John Delaney - *CapitalSource - Chairman and CEO*

That's right. I think the taxable REIT subsidiary will be substantial for us and we can retain those earnings if we choose. That would result in a lower dividend, and that may be the right thing to do at the time for the shareholders. We may put forth a case at that moment in time that's the smart answer, and if we believe that, we'll make that case. That's not something we're anticipating doing at this point. We take some comfort that we have the flexibility to do that. But I think that we always have to - if we want to add assets to this company, we have to ask ourselves, honestly, are these good asset opportunities, or by growing are we making the business worse.

We clearly believe that the growth that we've had in this company has made this business much better, and we think that's going to continue for the next two years, where we've done a lot of kind of bottoms-up work looking at the markets we're in and the opportunities that exist. And we'll continue to do that kind of with a two-year forward time view. And things change in these markets to change the opportunity and the investment environment for what we do. But if we think there's good opportunities, we will endeavor to fund them and will fund them either through raising capital, if that makes the most sense, or through retaining earnings, because we'll have the ability to do that. Not to the full extent we have now, but we'll have the ability to do that.

Unidentified Audience Member

It's obvious from listening to the presentation today that there's a lot of discipline around the whole issue of internal rates of return, which is constructive. But is there also just a per-share growth component to that discipline, when you're just simply saying, okay, a good opportunity produces X, Y and allows us to sustain growth after '07 of X? I think a lot of people are searching for what that number might be. An internal hurdle - an internal hurdle that's sort of going to drive your playing process.

John Delaney - *CapitalSource - Chairman and CEO*

Well, I think at this point all we can say that if we can continue to run the business for a 20% after-tax return on equity, recognizing we're paying less tax now, so there's more things we can do to get there, if we can continue to do that, that makes sense, assuming the cost of the equity is appropriate, because it's a bigger, more diverse, more balanced platform, and that's just all

good. So I think we would continue to do that if those investment opportunities existed. And we've looked at funding them either through raising capital or retaining earnings, whatever we view at the time as the best corporate finance alternative.

Unidentified Audience Member

Thank you.

John Delaney - *CapitalSource - Chairman and CEO*

Sure, but the key there is I think we look at these businesses and say there's just a certain return you should make for the risk, and if the market, like in our corporate finance business, isn't presenting those opportunities, it's going to be not a growth business. I mean, our corporate finance business has been flat this year, and it's something that we started talking about a year ago, that what was happening in that market was concerning to us, and we didn't think we would have a lot of growth, and to get the asset growth we would either have to lower our returns to a level kind of below standard for the risk, or just take on too much risk. And so we haven't done it. Obviously, part of our job is to have that discipline in everything we do.

Unidentified Audience Member

John, maybe one more question. Philosophically, when we talk about growth and ultimately growth must decelerate, is there a growth rate at which you, as the head of the company, start to think about strategic alternatives, if growth should slow down to the industry average growth rate. Would you be satiated with that growth rate over a period of time, or would it at that point in time be the best decision for shareholders maybe to look for a buyer of the company.

John Delaney - *CapitalSource - Chairman and CEO*

Well, I think we're committed to doing what's in the best interest of the shareholders. The management team and the board own close to half the company, and we're very focused on creating value for the shareholders. And I think every decision we make has that as kind of the punch line, if you will, including the decision we made on Monday. We think that creates tremendous value for the shareholders, both in the short term and in the long term, which is why we did it.

Historically, what's created the most value for the shareholders has been building the business, building the franchise, creating the platform we have now, and we expect to continue to do that. But I think the only way I can answer that question is to say that we're very focused on creating value for the shareholders and we will continue to do what we think is in the best interest of the shareholders. And if that should lead us down a path like you're suggesting, that's where it will lead us, but at this point that's not something that we view as being in the best interest of the shareholders.

Well, to wrap up, I think we've in this last Q&A covered most of what I wanted to comment on in the wrap up. There were really five things that we wanted to accomplish here today. First is to talk about the REIT, and I think we've done that, and hopefully explained to you why we think it makes so much sense for this business, both from a shareholder value creation and from a just purely thinking about the enterprise it make sense. The second thing we wanted to accomplish is explain our new reserve policy, why we think that makes sense, to have a reserve policy that is essentially at two times historical losses. And we've gone through that, and hopefully we've answered your questions around there.

The third thing we wanted to accomplish today was reiterate that this business at the end of the day is about credit, and we have a very strong credit culture. It's our credit-first approach to the business, and all of our businesses have a very strong credit angle to them, and I hope you get the sense that CapitalSource is not a business where people think trees grow to the sky. It's very much of a bottoms-up business where we're looking at assets, we're looking at collateral coverage, and we really are lenders, and that's how we approach the business.

The fourth thing we wanted to accomplish here today is to talk about asset growth. We are projecting asset growth for next year that is above what we did this year, and it's above what we did last year, and explain to you why we are very confident with that. We're confident with it because the rate of prepayments, which has been significant this year, is slowing down, we believe.

We're confident with respect to it because our business is broader than it's ever been and we have certain businesses, things like business credit services, that really were small business for most of this year and we think will be pretty sizable businesses by the end of next year and we continue to invest to build out some of these businesses.

And then the third reason is that there is some incremental growth associated with this REIT, our ability to lower the cost of capital, which we just talked about. I think we're just scratching the surface. We look forward to across the next 18 months to talk about other insights we have into how we can utilize this platform in this new structure to help build the business. And then lastly, we wanted to convey the sense to you, and I think this is important, that we're all very excited about this transition.

We made this transition, as I said earlier, from a position of strength. The board evaluated this opportunity against the backdrop of a very strong business, a business where staying the course would have been just fine, would have created a lot of shareholder value, and we just viewed this as a better option. And I think the board's very excited about it, and I can tell you that the management team is very excited about it. We think growth is good, in general, and this is an opportunity for us to grow this business.

So we appreciate you coming down and listening to what we had to say today. We're having cocktails and dinner for those of you who can stick around, and we encourage those of you who can to do it. Thank you for your time.